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The Institution was incorporated in 1927 to merge the Institute for Government Research, founded in 1916 as the first private organization devoted to public policy issues at the national level; the Institute of Economics, established in 1922 to study economic problems; and the Robert Brookings Graduate School of Economics and Government, organized in 1924 as a pioneering experiment in training for public service. The consolidated institution was named in honor of Robert Somers Brookings (1850–1932), a St. Louis businessman whose leadership shaped the earlier organizations.

Brookings receives financial support from philanthropic foundations, corporations, and private individuals; it also draws funding for its activities from endowment income, conference fees, sales of publications, and charges for computer services. In addition, the Institution undertakes some unclassified government contract studies, reserving the right to publish its findings.

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The officers and staff conduct a continual review of the Institution's fields of interest. Discussions with government officials, members of Congress, business leaders, foundation officers, and other scholars help to identify issues for study. Subjects are selected for study on the basis of their significance and timeliness, the adequacy of information and techniques of investigation, the availability of personnel and funds, and the relationship of the projects to the Institution's objectives. Each Brookings study is offered as a comprehensive scholarly treatment of a subject worthy of public consideration; the Institution itself does not take positions on policy issues.

T H E BROOKINGS R E V I E W

Fall 1989 Vol. 7, No. 4

5 Fool's Gold: How America Pays to Lose in the Olympics

Americans, through the commercial television networks, pay more than their fair share for the Olympics. Robert Lawrence and Jeffrey Pellegrum propose a way that we can pay less for the games, see more of them, and give more money to our athletes.

The Exercise of Leadership

11 Governing When It's Over: The Limits of Presidential Power

Most presidents, including George Bush, never receive a mandate from the electorate. Charles Jones discusses what happens when a president must govern without one.

16 The Ways and Means of Leading Ways and Means

Allen Schick surveys the rise and fall and rise again of the House's powerful tax-writing committee.



24 Third World Debt: Phase Three Begins

Treasury Secretary Brady's debt-reduction strategy has already led to agreement between Mexico and its bankers. Edward Fried and Philip Trezise assess the plan and its first test.

35 Answering the Demo-Doomsayers: Five Myths About America's Demographic Future

Roger Conner challenges the futurists who predict that a coming population decline will have detrimental effects on the economy and society.

Plus . . . Joseph A. Pechman remembered, p. 3. David Malone on economic co-operation in the Pacific Rim, p. 32. New publications on the weapons procurement process, the 1990 defense budget, Medicare's prospective payment system, a new highway pricing and investment policy, and decisionmaking on the floor of the House and Senate, p. 40. Letters, p. 43.

Brookings Books

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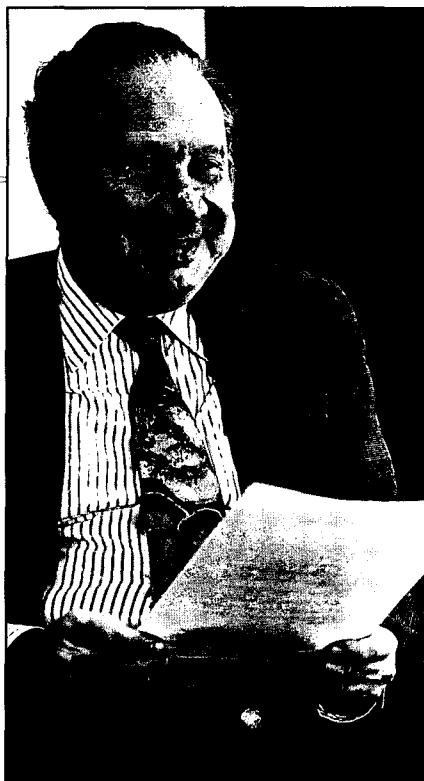
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XREV 74

Joseph A. Pechman

1918–1989



On August 19, Brookings Senior Fellow Emeritus Joseph A. Pechman died of a heart attack. This year marked his thirtieth as a member of the research staff at Brookings. From 1962 until 1983 Joe was director of the Economic Studies Program, and that program as it now exists is very much his creation. He recruited most of its current staff. He shaped the main directions of its research. Most important, he nurtured the blend of scholarly research, intellectual excitement, and social compassion that has characterized its working atmosphere and its publications. Joe became emeritus in 1988, but he remained an active contributor to the economics program. At his death he was working on four books and had just completed drafting his presidential address to the American Economic Association.

Joe launched two particularly important research efforts that exerted a major influence on the shape of economic policy at home and abroad. He conceived and personally directed the monumental *Studies in Government Finance*, which brought forth 55 vol-

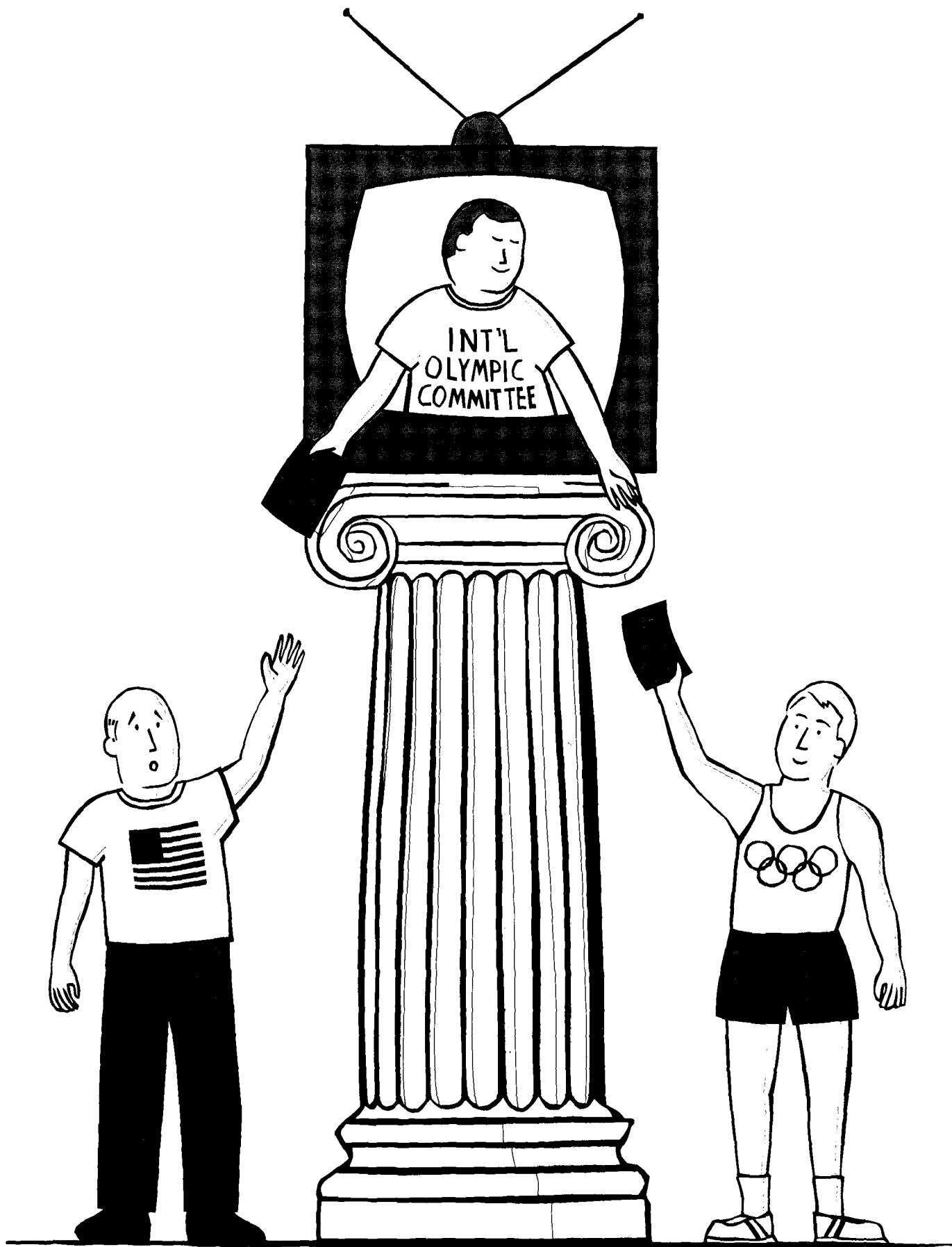
umes of research studies between 1961 and 1988. Those studies provided much of the intellectual ammunition for the struggle to reform the federal income tax system toward one with few loopholes, a broad income base, and low tax rates, an effort that finally bore fruit in the milestone tax reform legislation of 1986.

It was also under Joe's direction that the Brookings program of research in

the economics of government regulation was inaugurated. These studies formed a critical backdrop for what became, starting in the late 1970s, a successful effort to enact legislation substantially freeing important segments of the American economy from unnecessary regulation.

Yet Joe was more than a highly successful scholar and administrator. He had an uncanny ability to recognize professional talent, especially among young people, and a personal warmth and caring which helped that talent bloom. He was always a vigorous battler for the values about which he cared deeply. No one had any doubts about where Joe stood, but in the debate, however sharp, his opponents could always expect fairness and civility.

The Brookings Institution has established a special fund in Joe's name to bring outstanding visiting scholars to Brookings. This endowed fund will help continue what Joe himself did so well — enrich the climate for policy research in economic studies. Those wishing to honor Joe may make contributions to this fund.



Fool's Gold

How America Pays to Lose in the Olympics

Robert Z. Lawrence
with Jeffrey D. Pellegrum

*I*n 1988 ABC paid \$309 million for the U.S. rights to televise the Winter Olympic Games in Calgary. Guess how much all of Western Europe paid for its rights? \$150 million? \$50 million? Try \$5.7 million. The Soviet Union and Eastern Europe combined paid \$1.2 million. And Canada, the host country with an economy one-tenth the size of ours, paid about one-hundredth of what the United States did — \$3.65 million.

Surprised? Well, the Calgary experience was not unusual. Outbidding the other two U.S. networks, NBC paid the Olympic organizers \$300 million for the rights to broadcast the 1988 Summer Games in Seoul. In comparison, Western Europe, with a population 25 percent larger than that of the United States and an economy about as large, paid just \$28 million, or 9 percent of the U.S. payment. Even though much of the rest of the developed world has almost caught up with U.S. per capita incomes, the U.S. share of financing the Olympics has not declined (see tables 1 and 2).

So America is bankrolling much of the Olympic movement. What is the reward? Worse coverage. The huge price tag might be justified if American viewers received superior coverage. But broadcasters from all nations get

access to precisely the same feed. Unfortunately, the U.S. networks must run an enormous number of commercials to recover their investment. The ads clutter the broadcasts and have sometimes preempted important live action.

Our athletes receive little benefit from the networks' large payments. Those who prove themselves in glamour events, the Carl Lewises and Mary Lou Rettons, may be rewarded after the games with endorsements, but before the Olympics, the typical U.S. competitor is woefully underfunded. Support for national coaching programs, advanced training facilities, and junior development programs is also inadequate.

While other countries seem unable to raise much revenue to pay for television rights, they do somehow find the money to support their athletes. The socialist countries, in particular, have some of the most elaborate programs for their athletes, yet Eastern Europe and the Soviet Union combined paid only \$3 million for the TV rights to the Seoul Games.

In sum, the funding setup for the Olympics is a travesty. Americans get bilked in three ways. We pay more than our fair share for the games, we have to put up with an excessive number of commercials to see them, and our athletes receive little of the money we do pay.

It doesn't have to be that way. The United States can pay less for the games, see more of them, and fund U.S. athletes adequately. How? By having the networks compete for broadcast rights in an auction run by an American body that would limit commercials and use a significant share of the funds raised to support American athletes.

Robert Z. Lawrence, a senior fellow in Economic Studies at Brookings, is the author or editor of several books, among them American Living Standards: Threats and Challenges (1988) and Saving Free Trade: A Pragmatic Approach (1986). Jeffrey D. Pellegrum is a research assistant in the Economic Studies program.

The Bidding Wars

It doesn't take an economics genius to know that a seller maximizes his profits by making buyers compete. Assuming the sale of a single product, the seller will do best in an open auction. The International Olympic Committee (IOC) obviously understands this principle well. It spends an enormous amount of time and energy soliciting bids from the U.S. networks.

The bidding war for the Calgary Games is a perfect example of how the IOC exploits the intense rivalry among the networks to its own benefit. The Calgary Olympic Organizing Committee, supported by the IOC, strategically staged the auction for the 1988 games three weeks before the 1984 Winter Games in Sarajevo, Yugoslavia. The Calgary committee hired media consultant Barry Frank to help get the highest bids possible from the networks. According to *Maclean's*, Frank was to receive a percentage of the final bid if it was over \$200 million.

Acting on Frank's advice, the IOC scheduled the Calgary Games to coincide with the February Nielsen ratings sweeps and stretched the Olympics to 16 days, from 12 days, to gain an extra weekend of prime television coverage. The auction went on for several rounds, with the bids going up by \$20 million to \$30 million each time. CBS dropped out after two rounds, and ABC and NBC eventually deadlocked at \$300 million. At that point, Richard Pound, a member of the IOC executive board, changed the bidding procedure. "The \$300 million bid," *Maclean's* quotes him as saying, "is much more than we expected, more than the games are probably worth, but one of you is going to have to eliminate the other." ABC ended up with the rights with an offer of \$309 million.

The network was so embittered by the experience that it bid for the Seoul Games only halfheartedly and refused to

bid for the 1992 Winter Games in Albertville, France. In a subsequent article Jim Spence, a former senior vice president of ABC Sports, pleaded with the IOC to "avoid bidding procedures that leave even the victor with a bittersweet feeling." CBS outbid NBC for the rights to the Albertville Games, paying \$243 million, which, according to *The New York Times*, was \$43 million more than the figure the IOC later said it would have accepted.

This high pressure, head-to-head bidding certainly gets money for the IOC, but the benefits to the winning network are less clear. ABC lost an estimated \$65 million on the Calgary Games. Because of low ratings for the Seoul Games, NBC was obliged to give sponsors \$70 million in "make-goods" — free commercial time.

We Bid, They Negotiate

When it comes to the rest of the world, the IOC extends its hand with a kid glove rather than a tight fist. Other countries pay minimal amounts because their television networks do not compete for the broadcast rights. In fact, the offer for all of Western Europe is made by just one body — the European Broadcasting Union (EBU), a body whose members are mainly public broadcast networks. Similarly, the Asian Broadcasting Union makes the bid for many of the Asian nations.

The dealings these organizations have with the IOC are dramatically different from those of the U.S. networks. "Unlike the Americans," says Richard Bunn of the EBU, "we don't bid for the rights to the games; we negotiate." Once the EBU has obtained the European rights, it apportions the costs among its members.

One explanation for treating the United States differently is that it is so much richer than others. That was once true, but not anymore. In 1987 average incomes in West Germany

Table 1. Network Payments to the IOC for Olympic Broadcast Rights

Year	Network	Summer		Winter		
		Amount Paid	Percent of Total	Network	Amount Paid	Percent of Total
1960	CBS	\$ 394,000	33.4%	CBS	\$ 50,000	100.0%
1964	NBC	1,578,000	100.0	ABC	60,000	63.8
1968	ABC	4,500,000	46.2	ABC	2,500,000	76.5
1972	ABC	7,500,000	42.2	NBC	6,400,000	75.5
1976	ABC	25,000,000	71.7	ABC	10,000,000	86.0
1980	NBC	72,333,000	82.8	ABC	15,500,000	74.8
1984	ABC	225,000,000	78.6	ABC	91,500,000	89.1
1988	NBC	300,000,000	74.5	ABC	309,000,000	95.1
1992	NBC	401,000,000	NA	CBS	243,000,000	NA

Source: International Olympic Committee

Table 2. Payments to the IOC for TV Rights, by Selected Country

Country	Calgary Games	Seoul Games
United States	\$309,000,000	\$300,000,000
Western Europe	5,700,000	28,000,000
Japan	3,900,000	52,000,000
Canada	3,650,000	4,170,000
Eastern Europe, USSR	1,200,000	3,000,000

Source: International Olympic Committee

and the United States were equal, while those in Japan were 6.4 percent higher.

A second explanation for treating the United States differently is that its broadcast system is different. Foreign television broadcasters allegedly cannot raise revenues like those in the United States because they are noncommercial. But many countries have commercial networks that could carry the games, and some already do. In the United Kingdom, for example, the Seoul Games were aired by both the noncommercial BBC and commercial ITV (which split the \$3.7 million the United Kingdom paid the EBU for broadcast rights).

Commercial television is spreading rapidly. European television in particular is undergoing a revolution of privatization, deregulation, and commercialization. According to *Channels Field Guide*, by 1988 about three-fourths of Western Europe's broadcast channels carried advertisements. A comprehensive 1987 study by Logica Consultancy, Ltd., counted 16 terrestrial channels in Western Europe supported entirely by ad revenues (separate and apart from Sky Channel, Super Channel, and more than a dozen other commercial satellite networks). The same study predicted that "half of Europe's channels will be entirely ad-supported" by 1990. European advertising revenues were \$5 billion in 1985 and are expected to increase to at least \$7.5 billion by 1990.

In truth, therefore, the IOC does treat the United States differently. It has not taken account of changing circumstances such as the rise in European commercial TV, and the United States has never forced it to. Some of our laws even make it easy for the IOC to continue its unequal treatment. Antitrust laws prevent U.S. networks from banding together to offer a single bid; foreign countries with state-run networks typically prevent their commercial networks from bidding. If the IOC treated the United States equally, it would negotiate with the Public Broadcasting System instead of the commercial networks.

Moreover, while it tries hard to ensure the games receive widespread coverage in poor and socialist nations by giving them the feed at nominal rates, the IOC shows no concern about ensuring that all Americans have a chance to see the games in full. In 1992 it will apparently allow NBC to sell part of its coverage of the Summer Games in Barcelona to a cable operator. The network will probably

sell about 75 hours of less popular events to SportsChannel America, an East Coast-based division of Cablevision Systems Corporation. Americans who do not subscribe to cable will thus be excluded from viewing those segments of the games. If this development is taken to its logical profit-maximizing extreme, the Olympics could eventually be sold on a pay-per-view basis like prize boxing fights.

Events Between Commercials

In the meantime, the networks try to recoup their costs the only way they can — with commercials. The result is Olympics coverage that has become increasingly irritating to watch. "There were so many commercials during the Seoul Games," wrote Norman Chad of *The Washington Post*, "that the games seemed to be no more than a backdrop for Budweiser and Buick." He timed the commercials and found that during the opening ceremonies, American viewers got one minute of commercials for every four minutes of programming and "in the 5 o'clock hour, we got a whopping 17.5 minutes of advertisements."

All told, NBC interrupted its Seoul coverage with more than 5,000 commercials — nearly 42 hours worth if the ads averaged 30 seconds each. NBC broadcast 179 hours of Olympic coverage, which means Americans spent 23 percent of their viewing time watching commercials.

Ads that interrupt live events are an even greater irritant. During the Calgary Games, ABC averaged nine minutes of commercials for each hour it broadcast live events. Interruptions were particularly acute during hockey games. Because international hockey rules do not allow for TV timeouts, ABC had to break away from live action to show scheduled commercials. In the match between the United States and Czechoslovakia, three goals were scored while commercials were airing. As Gerald Eskanzi noted in *The New York Times* the next day, "in National Hockey League games, referees are signaled by a beeper when a commercial is over, and they can drop the puck [a face-off]. But this is the Olympics, and what did ABC expect for its \$309 million?"

And because costs are so high and the ratings so important, the networks show only those events that they believe will draw the largest audience. "Many more events

occur than ever see the light of U.S. television," Julian Goodman, a former president and chairman of NBC, wrote in a recent issue of *The Washington Journalism Review*. "Other countries provide more hours of coverage — not all of it as exciting as what we see, but all part of the Olympic games."

We Pay, They Play

What happens to the money the IOC receives for the TV rights? For the Seoul Games, the IOC said 47 percent went to the city's organizing committee, 10 percent went into a reserve fund for judges and officials, and 20 percent went to media and press centers. The remaining 23 percent was divided among the IOC, the international sports federations, and national Olympic committees.

This practice of rebating some of the TV spoils to the international federations and national committees dates back to the early 1970s when the TV revenues became significant. It means that not only are other countries not paying their fair share for the games, but that some of our TV money finds its way back to the national committees that organize the efforts of our Olympic competitors. While the IOC has refused to provide exact figures, the Soviet Union and East Germany could be receiving more through these IOC payments than they spend on their TV rights.

In the Amateur Sports Act of 1978, Congress designated the United States Olympic Committee (USOC) to serve as the coordinating body for U.S. amateur sports with exclusive jurisdiction to field and finance the best possible Olympic team. Unfortunately, the USOC has been ineffective not only in defending the United States against its separate and unequal treatment by the IOC, but also in

providing financial support for its athletes.

The USOC received just 2.5 percent of the \$609 million ABC and NBC paid for the 1988 games, and its share for the 1992 games will be only 10 percent. The USOC raises money from other sources, but little of it directly supports U.S. athletes. Most of the funds are spent on administration and fund-raising, training centers, and organizing and preparing for sporting events (see table 3). According to *Sports Illustrated*, only \$2.2 million of the USOC's 1985–88 budget of \$149.9 million was used for *direct* athlete support. That was equivalent to \$60 a month over four years for each of the 742 U.S. athletes that went to either the 1988 Summer or Winter Games. "The USOC money given directly to athletes, primarily for living expenses while in training, was less than the amount spent on travel, meals and lodging by the 30-odd committees that report to the USOC's executive board," the magazine reported.

The typical U.S. athlete seeking a berth on the Olympic team must overcome tremendous financial burdens. The 1989 Steinbrenner report on the state of the Olympic movement in the United States found that 85–90 percent of U.S. amateur athletes are "struggling" financially. The costs of training for an Olympic game are staggering. "Parents can spend \$30,000 annually on training for years," says Brian Boitano, the figure skater who won a gold medal in Calgary. Bonnie Blair, the speed skater who won the other U.S. gold medal at Calgary, used to have to sneak into ice rinks to train because she did not have the money to pay for ice time. These are the glamour sports in the United States, where U.S. athletes have traditionally done well. The situation is worse for less popular sports like field hockey and ski jumping.

Once U.S. athletes make it over the financial hurdles of

Table 3. How the USOC Spends Its Money, 1985–88
(In thousands of dollars)

	Amount	Percent of Total
Administration	\$ 48,100	32.1%
Administration	22,600	15.1
Fund-raising	20,800	13.9
Capital improvements	4,700	3.1
Direct Athlete Support	2,200	1.5
Indirect Athlete Support	29,600	19.7
Sports Development Grants	16,700	11.1
Sports Medicine, Science	12,900	8.6
Olympic Training Centers	19,900	13.3
Competitions	31,900	21.3
Games preparation	12,100	8.1
Events	11,400	7.6
Olympic Games	8,400	5.6
Handicapped Sports, Other	18,100	12.1
Total	\$149,900	100.0

Source: E. M. Swift and Robert Sullivan, "An Olympic Quagmire," *Sports Illustrated*, Sept. 12, 1988. Totals do not add due to rounding.



"As the world's richest economy, the United States should remain the largest contributor to the games, but others should pay their fair share. The United States can reduce its payment to the IOC, increase private support for its athletes, and improve television coverage of the Olympics with three steps."

training for an Olympics, they must compete against state-supported athletes from Eastern bloc countries like the Soviet Union and East Germany. These foreign athletes not only have their living expenses paid for by their governments, but they also enjoy excellent coaching and training facilities.

Given these imbalances, it should be no surprise that U.S. athletes are bringing home fewer medals. The United States won 20 percent of the medals at the 1968 Summer Games in Mexico City. At the 1988 games, this number dropped to 13 percent. The decline has been even more severe for the winter sports. The United States won just 4 percent of the medals at Calgary, compared with 11 percent eight years earlier.

Congress and presidents have expressed interest in supporting U.S. athletes, but they haven't put any money where their mouths are — despite evidence that voters would endorse such action. A public opinion poll sponsored by the USOC in the fall of 1988 found that 90 percent of Americans favor government aid for the country's teams and that 60 percent specifically endorse the use of taxpayer monies. A small step in that direction was taken in 1988, when Congress passed the Olympic Coin Act, which authorizes the U.S. mint to make gold and silver commemorative coins for the USOC to sell. Revenues are projected at \$50 million, of which \$25 million will go to direct support of Olympic athletes, providing them with an average of \$7,000–\$10,000. According to Robert Helmick, president of the United States Olympic Committee, they need at least twice that much, \$20,000–\$25,000. Given the

current budgetary situation in Washington, however, it is clear that private funds will have to be raised to improve athletic funding in the United States. Here is a way that could be done.

How to Get More for Less

As the world's richest economy, the United States should remain the largest contributor to the games, but others should pay their fair share. The United States can reduce its payments to the IOC, increase private support for its athletes, and improve television coverage of the Olympics with three steps.

First, an American body — the government or the USOC — would hold the auction for U.S. rights to televise the games. Networks would be invited to bid, subject to three conditions: They could show no more than 10 minutes of commercials an hour; the telecasts must be available without fees throughout the United States; and live action could not be interrupted with commercials.

Second, the American body would submit an offer for the U.S. broadcast rights to the IOC based on what other nations pay. During a transitional period, say, through the 1996 games, the United States would offer to pay no more than half of all the money paid for the broadcast rights to the games. Thereafter, the United States, Western Europe, Eastern Europe, and Japan would make payments proportional to their per capita incomes, adjusted to reflect the attractiveness of the location of the games for viewing in their time zones.

Third, the American body would spend the difference between the revenue it raises at the auction and the amount it pays to the IOC on the direct support of athletes training for the games.

The clear winners from the plan would be the U.S. viewing public and American athletes. The IOC and those dependent on its funds would be the losers. In addition, advertisers would find airtime in shorter supply and thus more expensive. Since the broadcast quality would improve, however, each commercial should draw a larger audience. Ads would also be more effective because they would not be competing with so many others for viewer attention.

The networks would still compete for the broadcast rights, but they would bid less because the constraint on advertising would reduce their prospective revenues. Nonetheless, if they bid rationally, they would cover their costs.

In fact, if the networks each pledged to give the USOC a grant that matched its payment for Olympic TV rights and to restrict commercials to 10 minutes an hour, the essence of this proposal could be implemented immediately. Provided each network was prepared to adhere to these conditions, none would be at a competitive disadvantage in the bidding. Their bids to the IOC would have to be lower because they would have to factor their USOC grants and ad constraints into their calculations.

If the networks took these steps voluntarily, they could earn considerable public goodwill and avoid the regulatory oversight that might be required if this proposal were enacted into law. (Congress might have to grant the networks an antitrust waiver to hammer out the specifics of a volunteer pledge.)

Indeed, the networks almost came to an agreement to place a single bid for the broadcast rights to the 1980 Summer Games in Moscow. According to Julian Goodman, the three networks were negotiating with the Justice Department to work out an antitrust exemption when "CBS inexplicably withdrew." Goodman now advocates the creation of a nonprofit corporation to represent U.S. broadcasters before the IOC.

Undoubtedly, the IOC and other countries will respond with great indignation to the proposal outlined here. They will claim that they simply cannot raise enough money and that the games will be destroyed. But the IOC can compensate for the decline in its U.S. revenues in four ways.

First, it can make other countries pay more. Those countries who insist that their noncommercial, state-owned networks must show the games would have to raise money through higher fees or taxes. In other countries commercial networks could be given greater participation.

Second, the countries holding the games can pay more. The prestige, publicity, and tourist revenue generated by the Olympics are large enough that some countries would play host, even if they lost money on the games themselves. Before the 1984 games, when TV revenues skyrocketed, host countries shouldered a large percentage of the cost.

The 1984 Summer Games in Los Angeles proved an Olympics could be hosted at no loss without U.S. television revenues. The Los Angeles Olympic Organizing Committee

(LAOOC) persuaded businesses to sponsor construction of Olympic sites and used existing sites to keep costs to a minimum. Although the timing of the payments for the TV rights to the LAOOC makes it difficult to reach a precise conclusion, it appears that the \$223 million surplus generated by the Los Angeles organizing committee was greater than its share of the \$225 million ABC paid for the broadcast rights.

Third, the IOC could raise the funds in other ways. In particular, it could expand its drive for corporate sponsors. It already has an international fund-raising campaign called The Olympic Programme, or TOP. Between 1984 and 1988 TOP sponsors put up more than \$100 million for the exclusive use of the Olympic logo for promotional purposes in 156 countries. According to *Fortune*, U.S. companies contributed about two-thirds of the money (and only a mere 13 percent, or \$16 million, of the TOP funds went to the U.S. Olympic Committee). The program could easily be expanded to include more foreign companies.

Fourth, as many have suggested, the costs of holding the games could be dramatically reduced by moving them to a permanent site in Greece. Such a shift would also have considerable benefits in reducing the political problems often associated with the games.

There are many areas in which the United States currently pays more than its fair share of the global burden. The most notable is its role in the defense of the Western alliance. In that case, at least, the United States retains considerable influence in the decisionmaking process. The Olympics are different. While the United States pays a disproportionate share of the money, it has minimal influence. Implementation of the proposal outlined here would tilt the balance of power toward the American body and away from the IOC, which is currently unresponsive to U.S. concerns. Instead of playing the three U.S. networks against one another, the IOC would face a single U.S. buyer prepared to ensure that the United States pays only its fair share.

The Olympic Games have become the world's greatest international sporting event. At the first modern Olympics in Athens, 311 athletes representing 13 countries competed in 42 events. By 1984 the games had grown to truly global scale, with over 8,500 athletes representing 140 countries competing in 263 events. This spectacular growth did not come without a price tag. In order to play the game, someone has to pay. Over the past 16 Olympics, that someone has been the U.S. television networks.

It is time for the rest of the world to find a more equitable financing mechanism. It is also time for the United States to take better care of its own athletes and the viewing public. A conservative estimate suggests that the proposal offered here could easily provide \$100 million for our athletes each four years. Some 2,500 promising U.S. athletes could be given annual stipends of \$20,000 each in the two years preceding the games. The proposal would also ensure that the games would not be parceled out among broadcasters or crammed with commercials at the expense of American sports fans.

Governing When It's Over

The Limits of Presidential Power

Charles O. Jones

A post-election cartoon in 1988 shows movers carrying a large trophy marked "mandate" out of the White House. As George Bush looks on, an aide explains: "That goes back with the Reagans, George." No one doubted that Bush had won the right to occupy the White House for the next four years. But the common observation was that he lacked a mandate.

Soon after this judgment was rendered, the new president was criticized for failing to produce large-scale proposals to deal with the issues of our time. He moved too slowly to suit the professional White House watchers. "President-elect Bush has hit the ground limping" is the way Tom Wicker of *The New York Times* saw it. "Five weeks after the election he is still hedging on major program decisions..." Failure to receive a mandate was not mentioned.

Ronald Reagan was said to have received a mandate in 1980. His impressive victory over an incumbent president, combined with significant gains for congressional Republicans, surely meant that Americans wanted the kind of changes "Reaganism" represented. Yet the 1984 election

was described as a "landslide without a mandate," and early talk of lame-duck status for Reagan grew louder following the 1986 mid-term elections. Mandates aren't forever.

"Governing when it's over" means figuring out not only how to govern when the election is over but also how to govern in the face of serious challenges to the president's right or power to do so. Presidents must be prepared to take advantage of opportunities; they must restore confidence and legitimacy when damaged by events like the Great Depression, Vietnam, Watergate, Americans held hostage in Iran, the Iran-contra scandal. That has always been so. But it is of special interest for the post-World War II period in which the majority party has won but four of eleven presidential elections.

Under what conditions is it said to be over for a president? And how do these conditions help us to understand the startup of the Bush presidency? Those are the questions to be treated here.

The Lame Duck

The most obvious case of governing when it's over is the lame duck. As originally applied to the president, the phrase referred to one who was not reelected — Grover Cleveland, Benjamin Harrison, William Howard Taft — and who then served during the long period from the election until the inauguration of the new president. For most of our history, that period lasted for four months, from the election in November until March 4 of the following year. In 1933 the

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20th Amendment shortened the period by setting the inauguration date on January 20. However, the concept is still applicable. Jimmy Carter is the most recent case of the classic lame duck.

The 22nd Amendment, ratified in 1951, introduced a new version of the lame duck. Since "no person shall be elected to the office of the President more than twice . . .," a *reelected* president may be labeled a lame duck for his entire second term. This perversion of the original usage is defined less in terms of legitimacy, as is the case with a defeated president, than of effectiveness. A second-term president is presumed to have lost influence precisely because he is ineligible for a third term. He is thus faced with having to govern as other politicians plot their elevation to his office.

The size of the reelection margin does not appear to compensate. Consider the 1984 election. Ronald Reagan won every state but his opponent's home state of Minnesota, which he lost by fewer than 4,000 votes in more than 2 million cast. Reagan garnered 59 percent of the popular vote — 54.5 million votes, the most ever — and 98 percent of the electoral vote. Yet, as Karen S. Johnson has noted, "in the network coverage of the 1984 Presidential Election, news anchors Tom Brokaw, Dan Rather, and special news correspondent Roger Mudd suggested that the entire second term of Ronald Reagan would be a lame-duck presidency." Theirs was a commonly accepted characterization.

When the Democrats recaptured control of the Senate in 1986, talk of Reagan's lame-duck status was renewed. The strengthening of congressional Democrats, the preoccupation of the White House with the Iran-contra scandal, and the approaching 1988 presidential election led to widespread predictions of legislative stalemate. The last two years of Reagan's presidency were expected to produce little. In fact, the 100th Congress was one of the most productive

in recent decades. At the very least, that experience should encourage analysts to reconsider the lame-duck scenario, based as it is on questionable assumptions about the nature and dynamics of national policymaking in the modern age.

The Mandate

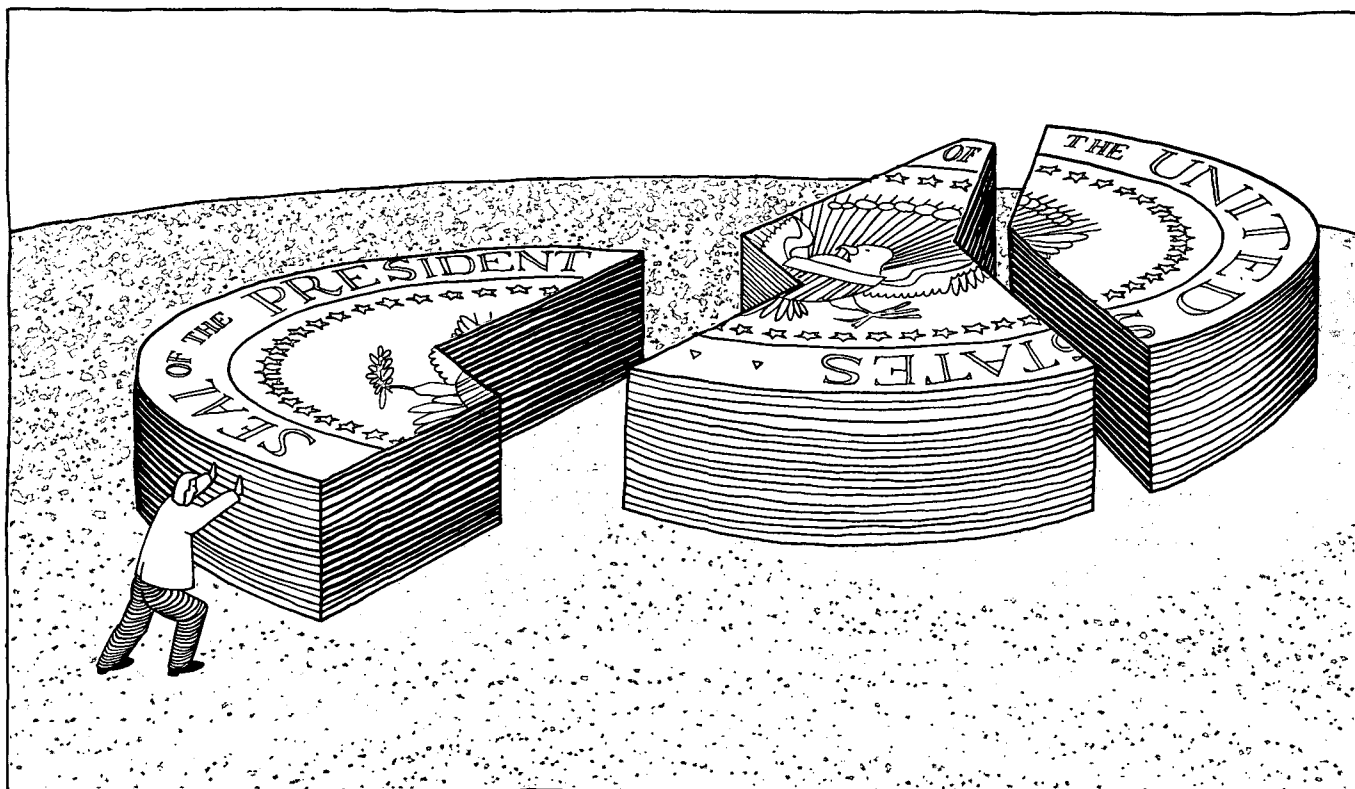
Many years ago the eminent political scientist Robert A. Dahl urged caution in deriving policy messages from political elections. "We can rarely interpret a majority of first choices among candidates in a national election as being equivalent to a majority of first choices for a specific policy," he wrote in *A Preface to Democratic Theory*. From the very start, the design for creating a government through elections made it unlikely that votes for national offices with staggered terms — House, Senate, president — could be integrated in a policy sense. Exactly the opposite was the intention; the election system was meant to reflect the perspectives of the differing groups empowered to elect (originally, eligible voters for the House, state legislatures for the Senate, and designated electors for the president).

Still the concept of the mandate is attractive, partially as a means around, or through, the complexities and ambiguities built into the election system, and the term arises frequently in post-election analysis. Some presidents are declared to have received a mandate — Franklin Roosevelt in 1932, Lyndon Johnson in 1964, Reagan in 1980; other presidents are said to have no mandate — Richard Nixon in 1968, Carter in 1976, Reagan in 1984, Bush in 1988). The phrase "landslide without a mandate" has come into favor in recent elections where Republicans have overwhelmingly defeated Democrats.

Raymond Wolfinger confronts the mandate and, like Dahl, declares that "election returns are almost always useless as measures of public opinion on particular measures." He argues persuasively that "mandates are inherently implausible." Beyond the problem of interpreting votes for officials with different electors and length of terms is simply the contrary behavior of the American voters. These passages from his essay in *The American Elections of 1984* illustrate Wolfinger's point: "For one thing, many people vote for their party's candidate almost reflexively; a cataclysm would be necessary for some faithful Democrats and Republicans to cross party lines. Others base their votes on the candidates' apparent personal qualities. . . . People who believe in mandates usually say that those who voted for a candidate did so because they favored the policies he advocated. The search for the mandate becomes a textual analysis of the winner's campaign utterances. The problem here, of course, is that candidates say a great many things. . . . As Chairman Mao might have said, 'Many issues, one vote.'"

There are cases nonetheless when one vote does seem to provide instructions on many issues. Johnson's election in 1964 and Reagan's in 1980 are such cases. Often subsequent analysis casts doubt on the validity of the mandate. It is discovered that voters were rejecting Barry Goldwater and Carter rather than endorsing the policy proposals of

"Presidents are expected to lead as though they had been granted full power to do so, even by those who earlier questioned the legitimacy of their claim to leadership for lack of a mandate."



Johnson and Reagan. A Herb Lubner cartoon in 1982 nicely captures the idea. Ed Meese is dusting off a document for the president that reads: "1980 Election Mandate to R. Reagan to be somebody who is not named Jimmy Carter." But in the short term, the notion that a landslide election constitutes endorsement of a president's proposed program is a persuasive idea and can have profound political and policy effects.

Under what circumstances are the pundits likely to declare the existence of a mandate? Taking 1964 and 1980 as the recent cases, it seems to require the following five components:

- ▣ A landslide victory as a demonstration of public support.
- ▣ Publicly visible issues debated during the campaign.
- ▣ Clear differences between the candidates on the issues, preferably deriving from ideology.
- ▣ A party win as well as the personal victory for the president, notably for congressional seats.
- ▣ A surprise. The president did better than expected, for example, or his party won more seats in Congress than had been predicted.

Put together, these conditions are taken as evidence for a mandate, for a policy message from the voters to their government. Dahl and Wolfinger argue that the evidence is circumstantial, at best, but regrettable as it may be, official Washington is more likely to listen to the post-election analysts than to two of the nation's most distinguished political scientists.

In fact, the declared mandate has a self-enforcing quality that makes it difficult to deny even should elected officials choose to do so. The expectation is: "You won it all, now do

what you promised to do." Adversaries may even be willing to cooperate, as Democratic Speaker of the House Thomas P. O'Neill did following the 1980 elections. "Despite my strong opposition to the President's program," O'Neill wrote in *Man of the House*, "I decided to give it a chance to be voted on by the nation's elected representatives. For one thing, that's how our democracy is supposed to work." Given this support, a significant strategic problem for the president is how to meet expectations without setting too high a standard. For he will be measured by that standard — and most likely be judged as having fallen short — once the mandate is declared to be exhausted.

The 1964 and 1980 cases are exceptional. *Most of the time presidents must govern when it's over because it never really begins.* In one sense, I suppose, that is not saying much. It asks us to analyze the strengths and weaknesses of each individual presidency in creating standards for evaluating success. It questions the existence of a systemic executive leadership capability emanating from elections and constitutional authority. In another sense, though, failure to recognize that each president must fashion his own means of exercising power leads to distorted judgments about presidential effectiveness.

Presidents are expected to lead as though they had been granted full power to do so, even by those who earlier questioned the legitimacy of their claim to leadership for lack of a mandate. Jimmy Carter had this experience — often being measured against the early months of the Johnson administration. And George Bush may be held accountable to standards for exercising power that were established by and for Reagan during his early months in office, when he was declared to have a mandate. It is not

When the Time Has Come

Five different conditions may require a president to “govern when it’s over.” These are (with recent examples):

1. The classic lame duck: a president who was defeated in his reelection bid and must continue to govern for another two and one-half months (Carter).

2. The declared lame duck: a president who wins reelection, even by a landslide, and now faces having to govern without the benefit of a third-term option (Eisenhower, Nixon, Reagan).

3. The *passé* lame duck: a president who cannot or does not seek reelection and must govern for two and one-half months after the election of a new president (Johnson, Reagan).

4. The unmandated president: a president originally declared to have a mandate but who experiences a loss of public and congressional support (Johnson by 1966, Reagan by 1982).

5. The no-mandate president: a president who clearly does not have a mandate, who must fashion coalitions of support for his programs (most post-World War II presidents).

easy for presidents to score well under these conditions. What I propose here is that we begin to pay more attention to how they try.

When It's Over from the Start

The 1988 presidential election had many special features. George Bush was the first sitting vice president since Martin Van Buren in 1836 to be elected. (It should be noted that few have tried. Nixon in 1960 and Hubert Humphrey in 1968 were the only other cases in this century.) Bush also was the first elected president since Herbert Hoover in 1928 to follow a president of his own party. These precedents, and the fact that the Democrats had regained the White House after the previous two-term winners, Dwight Eisenhower and Nixon, led many to expect a Democratic win in 1988.

Indeed, Bush won a 40-state victory that met few of the conditions for a declared mandate. While a sizable win, Bush’s share of the electoral college vote (79 percent) actually ranked 13th among the 23 presidential elections in this century, and his share of the popular vote (54 percent) ranked 12th. Though there were any number of national problems, there were few the candidates chose to debate. Ideological lines were drawn on certain symbolic issues, such as furlough policy for criminals and saluting the flag, but were left murky on the major domestic and foreign policy problems. Bush could not claim a coattail effect since only two House Democratic incumbents and one Senate

Democratic incumbent were defeated. In fact, the new Congress was very much like the old Congress — nearly 99 percent of House incumbents and 85 percent of Senate incumbents seeking reelection were returned. And finally there were no surprises; the election went more or less as expected. Indeed, it bored most analysts and, possibly, many voters as well. Turnout barely exceeded 50 percent — the lowest percentage in 64 years.

Thus George Bush entered the White House “in search of a mandate,” as most accounts had it. He succeeded a president with whom he had served and who had left office with exceptionally high public approval. Comparisons were bound to be made — typically with Reagan’s first year, not his last. Bush faced a Democratic Congress emboldened by recent policy successes and energized by new leadership in the Senate.

The case can be made, therefore, that Bush had to build his presidency from the start. He had few advantages beyond his electoral right to occupy the White House. It is unlikely that congressional Democrats viewed Bush’s victory over Michael Dukakis as challenging their right to govern. After all, like Carter, Dukakis was a politician from out of town. House and Senate Democrats separated their campaigns from that of the national ticket. And, indeed, their representative in the presidential race, Lloyd Bentsen, returned, losing in his home state for the office of vice president but winning reelection to the Senate.

If the election did not automatically convey the right of leadership to George Bush, can it be said to have endorsed the Democrats’ right to lead? Surely not. Their presidential candidate was overwhelmingly defeated. And the high return of congressional Democrats carried with it limited policy implications. Mandates are even more implausible for congressional elections. In 1988, as in the two previous presidential elections, the Democrats emerged from the election with neither a message nor a messenger. Further, Speaker Jim Wright was being investigated by the Committee on Standards of Official Conduct (and later resigned), Majority Whip Tony Coelho was about to be investigated (and later resigned), a new majority leader was elected in the Senate, and an early congressional battle was fought over a pay raise — a matter bound to damage the public image of Congress.

Thus the president’s first advantage was simply that he was the only leader in town, and so George Bush sought to establish a government. His strategy in the early months appears to be bipartisan, consultative, inclusive, continuous, incremental, and nonideological. Accepting the limitations of a low-turnout, issueless election that returned a Democratic Congress (as well as confirmed Democratic strength in the states), Bush emphasized the need for a bipartisan approach to major issues. He sent signals before the inauguration, then confirmed his intentions in his inaugural address: “I put out my hand. I am putting out my hand to you, Mr. Speaker. I am putting out my hand to you, Mr. Majority Leader. For this is the thing: This is the age of the offered hand.” The bipartisan approach soon proved successful in the development of a budget agreement and a

plan for aiding the contra guerrillas in Nicaragua.

A corollary strategy to that of bipartisanship is consultation. It may be expected to be employed on any issue requiring joint action by the White House and Congress. But it is particularly effective as a governing strategy if the president uses it when he has the prerogative to act alone. The Bush White House has consulted with members of Congress in both cases. His clean air proposals, which require congressional support, and the actions following the Panamanian elections, which don't, are two of the more important examples.

An administration that must establish its right to govern is well advised to reach out, to be inclusive. Though criticized for not doing more, the Bush administration did use cabinet and subcabinet appointments for this purpose. The president and his political advisers also sent signals to various minority groups that the White House would consult them much more frequently than the Reagan White House did.

Continuity was also part of the transition strategy. Certain appointments were made in the latter months of the Reagan administration that could be carried over — Attorney General Dick Thornburgh, Education Secretary Louis Cavazos, Treasury Secretary Nicholas Brady. Other Reagan cabinet members, or former members, were reassigned — Elizabeth Dole, from Transportation to Labor; Clayton Yeutter, from trade representative to Agriculture; William Bennett, from Education to drug czar. Many subcabinet positions were also holdovers. The Bush administration was criticized for not moving more quickly to replace Reagan appointees or to fill vacancies. Yet deliberateness is a feature associated with all the strategic moves mentioned here. Establishing a governing strategy following a no-mandate election typically requires patience, at least in the absence of a major crisis.

Finally, and consequently, new directions for a no-

mandate president are likely to be incrementally pursued. Bold policy plans are bound to be criticized as lacking public support. Because he was vice president in the administration of his extremely popular predecessor, Bush's new policy directions will be taken in oblique rather than sharp angular moves. An incrementalist is likely to be less ideological and therefore, perhaps, less predictable and less able, or motivated, to propose an integrated program.

Meanwhile the role of the congressional Democrats in the early months of the Bush presidency has been confined primarily to cooperation. With the exception of the rejection of John Tower's nomination to be secretary of Defense, the Democrats are finding it difficult to establish a consistent policy posture that will permit them to win when President Bush loses. It would not be popular to turn away from a president willing to "put out my hand." And so Democrats must make an effort to cooperate where called upon to do so. Yet agreements with the Republican president make it harder for the House and Senate Democrats to delineate their policy record. Democratic policy initiatives are diffused by agreements reached in advance. And independent actions, as with the minimum wage increase, are subject to veto.

The Nature of Contemporary Power

Presidents must find, understand, and protect their power. That is not a new observation, to be sure. It is the very essence of Richard E. Neustadt's *Presidential Power*. What is new since the publication of that influential book in 1960 is that American voters have frequently separated the presidency from the rest of the political system. Five times they have elected Republican presidents and returned Democratic majorities in one or both houses of Congress. In four of the five elections, the Republican candidates won by huge margins. And in the 1976 election, the Democrats won by the barest of margins with a candidate who separated himself from his party.

However fragile presidential power was before 1960, it has become more so. Presidents have to construct and reconstruct their presidencies, evaluating their advantages and commitments. Few are awarded mandates — only Lyndon Johnson and Ronald Reagan since 1960. Some, like Nixon in 1972 and Carter in 1976, proceeded as though they had received one, suffering the consequences of their miscalculation. All are affected by events — foreign and domestic crises, scandal, elections and reelections — that subtract from, or occasionally add to, their decisionmaking advantages. There are no pat formulas. Coalitions gathered for one issue are seldom available for the next. And reelection even by a 49-state sweep may still require a president to create additional advantages.

"Governing when it's over" is a perspective for our time. All presidents must recognize and interpret developments as a first step for determining how they will manage. Our understanding of the office in contemporary politics will be improved if we, too, comprehend the changing political and policy conditions that make this perspective credible.

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The Ways and Means of Leading Ways and Means

Allen Schick

The chairman "no longer has the tools to control Ways and Means," congressional expert Catherine Rudder wrote in 1983. "The chairman now has little to offer members as inducements to cooperate." This dismal conclusion appeared at a time when many members of the House Ways and Means Committee, as well as many others in Congress, looked back at the Mills era (1958–74) as the golden years of the committee's effectiveness. In his prime, Wilbur Mills had forged a consensus that protected the committee and its legislation against outside challenge. But a series of reforms in the early 1970s stripped the chairman of many of the tools he had used to keep committee members in line and to shepherd legislation through the House and conference committees. Mills' successor, Al Ullman (1975–81), presided over a committee weakened by partisan strife and by adverse changes in the environment within which it operated.

Dan Rostenkowski's early record as chairman seemed to confirm the accepted wisdom that Ways and Means could no longer be guided by a strong leader. In 1981, his first year, the new chairman suffered a serious defeat when House (and White House) Republicans substantially rewrote the

massive tax reduction bill reported by the committee. The next year, Rostenkowski sustained another blow when Ways and Means Democrats rejected a revenue-raising package he had proposed. The chairman then withdrew from the fray, allowing the Senate to take the initiative on legislation that raised taxes and pared billions of dollars from Medicare and other social programs.

With those two losses, it seemed that the committee had little hope of regaining its former stature. In retrospect, though, the debacles of 1981 and 1982 can be seen as formative experiences in the emergence of new patterns of leadership that have restored the Ways and Means Committee to its position of preeminence in the House. Since 1983 the committee has produced a steady flow of significant legislation, including that year's rescue of the Social Security system, the 1986 tax reform, and four major budget reconciliation bills. The 100th Congress (1987–88) was extraordinarily productive, enacting three truly important measures that emanated from Ways and Means — expansion of Medicare's protection against catastrophic illness, an omnibus trade bill, and welfare reform.

These successes occurred in a less than favorable environment. The reforms of the 1970s have not been repealed, although some of their impact has been blunted, and the political antagonism between the Democratic House and the Republican White House has sharpened partisanship. Fiscal stresses have forced the committee to take politically painful actions. Gone are the good old days when the committee could parcel out benefits in the form of tax cuts and program expansions without having to

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worry about how to pay for them. In the 1980s the dominant need has been to impose losses, such as tax increases and spending cuts prescribed by the annual reconciliation cycle.

Ways and Means has regained its status and effectiveness by resorting to a simple formula that worked for it in the past: the committee is successful when it controls the House and when the chairman controls the committee. The chairman is the critical link. By dominating the committee, he enables the committee to be dominant in the House.

The Chairman's Task

To be effective, the Ways and Means Committee must harmonize the interests of rank-and-file members with the institutional need to act responsibly and collectively. All congressional committees must try to balance individual and institutional perspectives, but the task is complicated for Ways and Means by its vast and controversial agenda, its capacity to apportion gains and losses, and the range of interests affected by its work. In short, the job of forging an effective group is harder for Ways and Means, not because it is a weak committee but because it is a powerful one. Members may be tempted to capitalize on their Ways and Means affiliation and go their separate ways in writing legislation that benefits their constituents or satisfies their own political ideology. To counter this tendency, the chairman must convince members that the best route to individual power is through collective action.

One obstacle to collective action is the sway of interest groups; another is the pull of political ideology. As the flow of campaign contributions from political action committees to Ways and Means members demonstrates, the committee's jurisdiction is a strong magnet for interest group attention. It could hardly be otherwise for a committee that has the constitutional initiative in revenue legislation, oversees the Social Security system that dispenses monthly payments to almost 40 million Americans, actively legislates for Medicare (the fastest-growing federal program), and has a leading role in defining the economic relationship of the United States and its trading partners.

Ways and Means cannot act as if outside interests do not care about what it does or lack the capacity to influence legislative outcomes. The committee leadership cannot cavalierly insist that members disregard the strong pressures playing on them. Instead, it must be somewhat responsive to these pressures while striving to produce responsible legislation. When political pressures and legislative responsibility clash, the committee must hold on to as much of the latter while giving in as little as possible to the former. Trade-offs between the two can be messy and are not likely to earn the plaudits of editorial writers, but they are an essential part of Ways and Means leadership.

The committee's jurisdiction is also a magnet for ideological conflicts. The matters in its sphere of influence have occasioned some of the great fissures in American

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political history and continue to provoke deep divisions. Through the 19th century and beyond, the tariff was the great divide between both the parties and the regions. Trade is the contemporary version of this perennial issue, and it often pits the president's assumed role as a spokesman for free trade against protectionist pressures in Congress. Social Security is another case in point. Although Social Security is generally thought of as one of the settled policies of American politics, in fact it remains such a potentially explosive issue that politicians must handle it with great discretion and sensitivity, especially when there is talk of cuts in benefits. The issue of how government should best assist low-income persons has long divided liberals and conservatives; the opprobrium attached in the public mind to the word "welfare" attests to the difficulty of making policy on this question in a calm manner. Finally, Ways and Means has charge of revenues, a matter that can be highly contentious even when there is room to cut taxes but that can blow up into superheated conflict when there is a need to raise them.

This jurisdiction would lead one to expect Ways and Means to be among the most fractious committees in Congress. With so much to fight over, do members have any compelling reason to set aside their differences and advance common legislative objectives? Judging from the postwar record, the answer is yes. Members seem to recognize that their own legislative influence depends on that of the committee and its chairman. At the least, partisan conflict must be cooled so that issues taken to the floor are not fought over in stark Democratic-versus-

Republican terms. The committee may vote along party lines in the course of developing legislation, but members know that these partisan differences must be narrowed if the committee is to produce bills that will be enacted.

"Restrained partisanship" — the label ascribed to this behavior by political scientist John Manley — doesn't just happen. It must be actively promoted by the chairman. Closing ranks in committee is essential not only for reporting legislation but also for assuring reasonably smooth sailing in the House. When the committee is divided ideologically or politically on a bill, the odds are that the House will be similarly divided, increasing the risk that the measure will be rejected or revised on the floor.

To avoid that outcome, the chairman must manage the sprawling agenda and take charge in committee. He must also sell committee members on the idea that their status and effectiveness is intertwined with his success, that if he loses control of the committee, they lose control of their legislation.

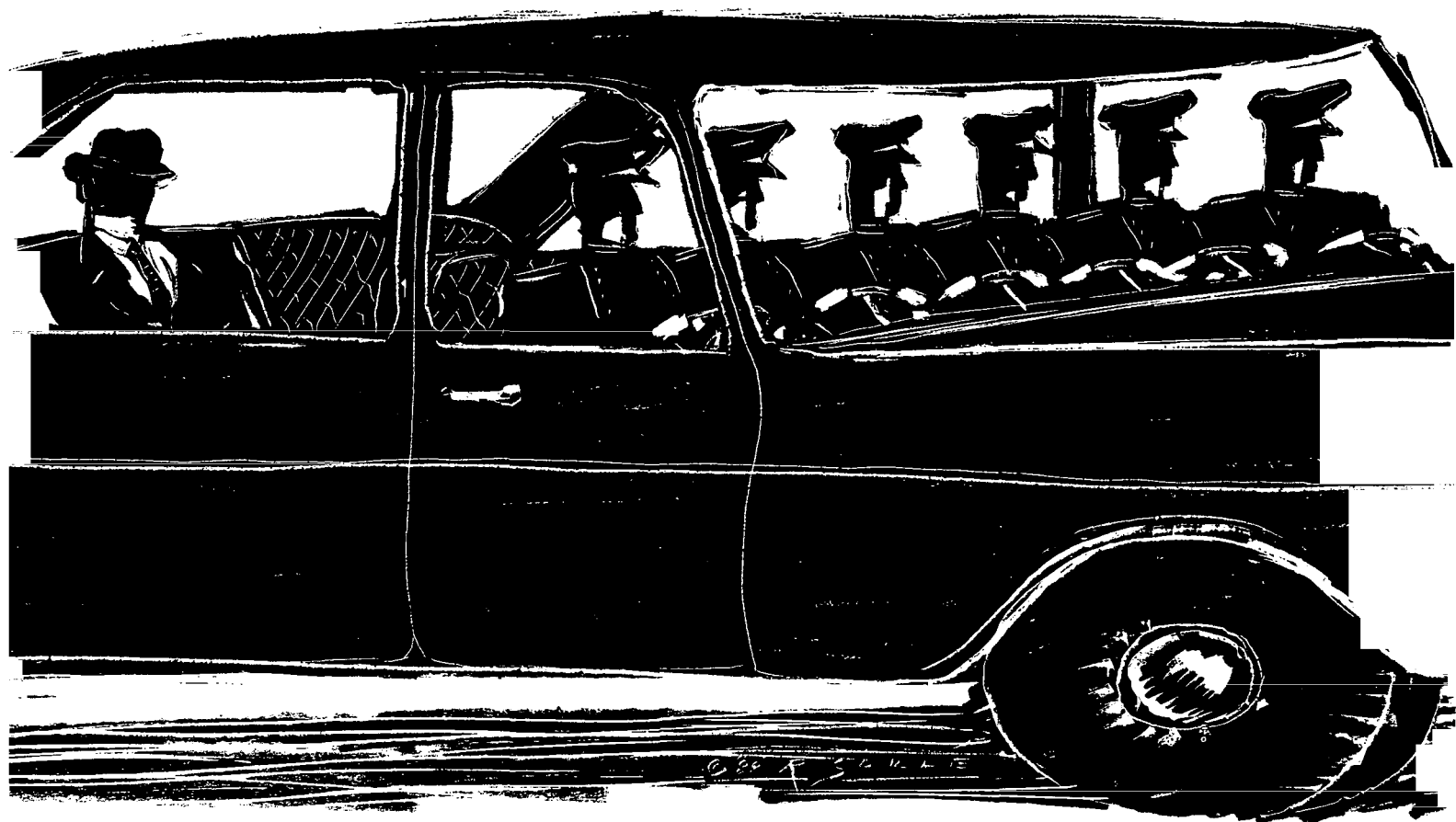
The chairman has to be the boss, though he cannot be bossy. He cannot be seen as arbitrary, nor can he ride roughshod over the things that really matter to rank-and-file members. He must attend to their interests because he needs their votes and, even more, because he needs their deference. Having accommodated members in committee, the chairman can confidently go to the House, get a rule limiting floor amendments, and guide the measure through the chamber intact.

The Mills Consensus

Wilbur Mills was well suited to the particular needs of the Ways and Means Committee. He was comfortable with a consensual style, and he was determined to uphold the power of the committee. Losing did not come easy to him. For Mills, the worst of all possible defeats was one on the House floor, for it meant the rejection not only of his legislative recommendations but also of his committee and his leadership.

Just about everything Mills did in committee was oriented toward the forthcoming consideration by the House. He sensed that the surest way to prevail on the floor was to have solid support in committee. "I think," Mills confided in a 1967 interview, "if I can get a vast majority of the membership of the Ways and Means Committee to agree upon something, that I've got a vast majority of the House agreed upon the same thing."

Leading by consensus, Mills was always in charge but rarely threw his weight around. His style was to persuade fellow members, not to strong-arm them. He would often sit silently through committee discussions, making his own views known only when a consensus had begun to form or when his intervention would help iron out differences. By being a good follower in this way, Mills was a great leader. To be sure, the committee's bills usually reflected his views, but not to the extent of jeopardizing floor success. Consensus building was facilitated by the committee's practice, espe-



cially in tax legislation, of discussing concepts rather than marking up specific provisions. Members were encouraged to talk until they felt comfortable with a set of ideas, which were cast into legislative language only after general agreement had been obtained on how to proceed.

Mills' style was so oriented toward consensus that one could rarely be sure of where his influence ended and the rest of the committee's began. The media understandably saw the strong hand of Mills in everything the committee did, for it was he who would articulate the emerging consensus or put the final touches on legislation earlier agreed to in principle. But as a consensus builder, Mills never strayed far from what he thought members would support. He could therefore be confident that most committee members would rally behind him when he took the legislation to the floor.

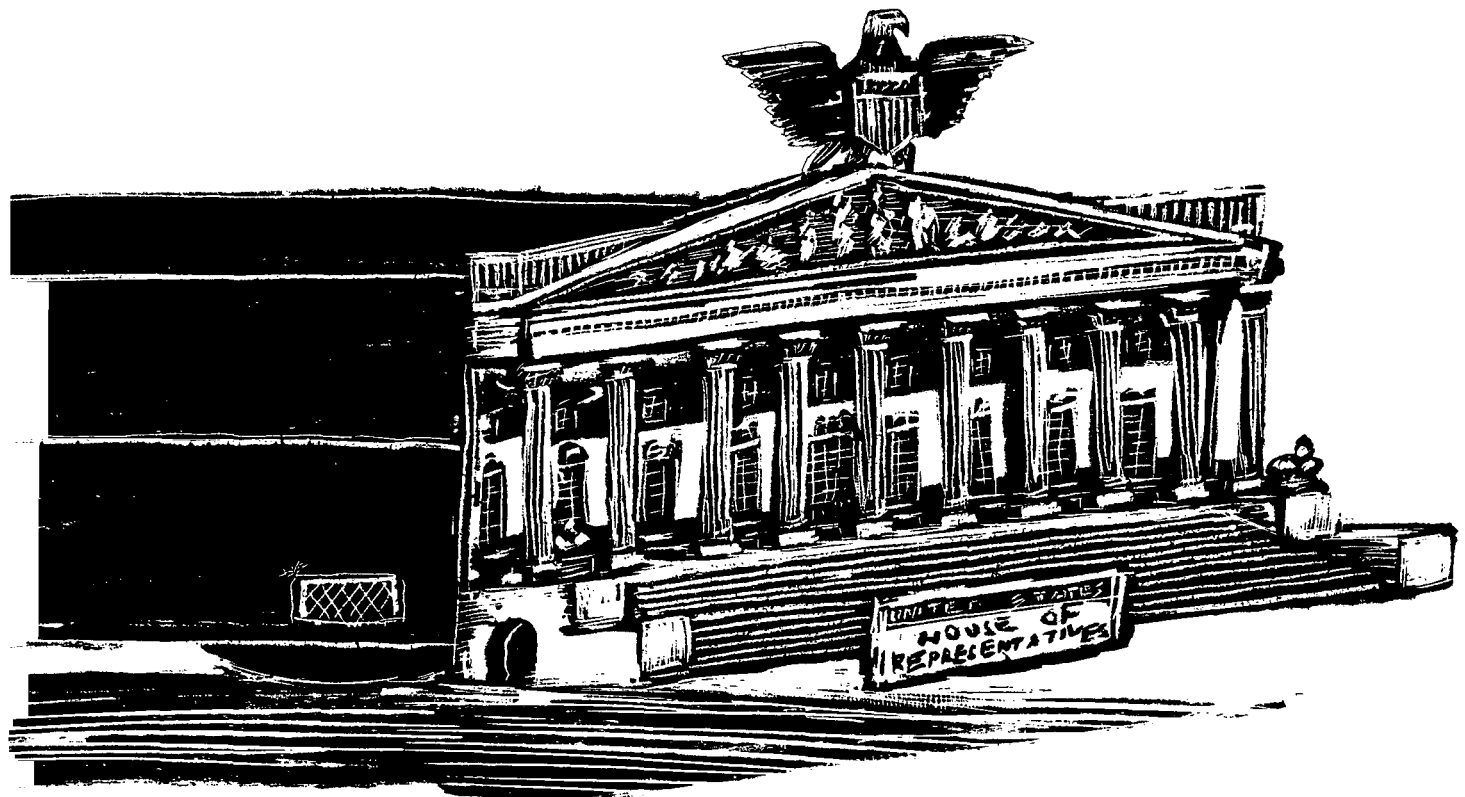
For consensus to thrive, Ways and Means had to be stocked with members who would, to paraphrase Sam Rayburn's famous remark, get along and go along. Care had to be invested in the selection of new members and in introducing them to the norms of the committee. With the single exception of George Bush, freshmen were not invited to join because their political temperaments were untested. Ways and Means was not the place for upstarts who came to Congress hellbent on quickly building a track record of legislative accomplishments. Members from safe seats were preferred because they could turn a deaf ear to local demands. With some exceptions (such as overrepre-

sentation of those who favored the oil depletion allowance), the membership had to reflect the political composition of the House. A committee that was a cross section of the House, Mills insisted, would have a good chance of getting its legislation approved.

Under Mills, Ways and Means operated without subcommittees, which meant that the chairman could keep a careful watch on developments without any threat of being outflanked by colleagues pursuing their own agendas. If an issue proved contentious, it would be set aside. The lack of subcommittees encouraged members to identify with the interests of the full committee rather than with the particular policy area in which they specialized.

Maintaining consensus required that partisanship be muted. Mills accomplished that through his relationship with John Byrnes, the ranking minority member, and by giving committee Republicans ample opportunity to influence the legislation. What Mills wanted, and often got, were lopsided committee votes to report legislation.

With consensus nailed down, Mills could request a closed rule protecting the committee's bill against amendment on the floor. During the Mills era, about three-quarters of the committee's bills and virtually all of its important measures came to the floor under a closed rule. But there was an implicit quid pro quo in permitting a closed rule: Mills would bring in bills that generally reflected the sentiment of the House. If the House felt that the legislation failed to meet this standard, it could vote



"Today the relationship of Ways and Means Democrats and Republicans falls . . . between the consensus of the Mills regime and the partisanship of the Ullman years. Rostenkowski's ease with interpersonal matters enables him to harmonize relations with the Republicans."

down the rule. That the House rarely did reflected the skill with which Mills built a committee consensus that represented the larger body's views.

The Triumph of Individualism

Yet this chairman, so keenly attentive to the mood of the House for so long, was by the early 1970s far out of step with the attitudes of the parent chamber. Mills' last years as chairman were dominated by a broad attack on Ways and Means. A series of reforms aimed at weakening the committee compelled it to set up subcommittees, open its meetings to the public, and add both members and staff. The committee was stripped of its power to make committee assignments for House Democrats, and it lost a small slice of its legislative jurisdiction. Ways and Means could no longer count on closed rules for its legislation, and its chairman, like all other House chairmen, could be made subject to approval by the party caucus. Before the reforms were fully in place, personal crises forced Mills to resign the chairmanship and retire from the House.

Mills had not entirely ignored changing political attitudes in the House. Despite his strong opposition in previous years, in 1965 he led the committee to enact Medicare and Medicaid legislation. The committee also ushered in the revenue-sharing program and expanded Social Security benefits in 1972.

But the assault on Ways and Means had little to do with its responsiveness on legislative matters and all to do with its accumulated power. The reformers did not have a particular legislative agenda; their aim was to redistribute legislative power from committee leaders to individual members. Their reforms were directed at all legislative concentrations of power, but because it was the most powerful House institution, Ways and Means bore the brunt of the reformers' zeal.

It was the triumph of individualism that turned the House, or more precisely the Democratic Caucus, against Ways and Means. No matter how responsive it had been to legislators' demands, the committee's consensual style had to go because it gave primacy to disciplined group values over the unfettered rights of individual members. A consensual committee was oriented to success in the House; an individualized committee would be responsive to the Democratic Caucus. Of course, in coming under the influence of the caucus, the committee could no longer hold on to its cherished bipartisanship.

On paper, one might have expected Al Ullman, Mills' successor, to have an easy time satisfying caucus demands and getting legislation through the House. In the aftermath of Watergate, the House Democratic majority swelled; Democrats outnumbered Republicans by more than 2 to 1 in both the 94th and 95th Congresses (1975-79). This numerical superiority led to a change in the formula for dividing Ways and Means seats between the two parties, expanding the Democratic margin from 5 seats (15-10) to 13 (25-12). With the capacity to outvote the Republicans, the Democrats should have been able to act without having to rely on the minority.

Operating on that assumption, Ullman abandoned Mills' practice of involving Republicans in the development of legislation. With no stake in the committee's work, the Republicans defected in droves. "When Ullman asks us for votes," Republican Barber Conable admitted, "the answer is usually no because we've given little input." For their part, the Democrats said efforts to win Republican support were futile. "On every important bill we've had," Ullman complained, "they've always had a reason for being against it."

Reliance on the Democratic majority proved inadequate for developing passable legislation. In an era of individualism, the Democrats could not be held together. Lobbyists, who because of the reforms now had greater access to the committee's deliberations, could more easily isolate individual Democrats. And once its consensus was shattered, Ways and Means was treated by the House almost like any other committee whose legislation was only a recommendation that could be recast to suit the preferences of the larger membership.

Losing did not bother Ullman. "I don't worry about being defeated on the floor," he said in 1976. Perhaps Ullman was only conceding to the realities of the times, but his attitude may also have further weakened Ways and Means. A committee that didn't care about losing would lose, not only legislation but also the special status it had

enjoyed in the House. Even more important, its own members no longer saw Ways and Means as having a special claim on their loyalty and support. In this individualized setting, the chairman was just one of the players, doing his own thing as other members did theirs. The image etched in history of Ullman's leadership is of the chairman convening the committee to explore the possibility of a value-added tax. Few members attended the hearings, and those who did sought to distance themselves from the politically controversial issue, leaving the chairman virtually alone in the hearing room. The chairman had failed to shelter the committee and, in the end, it did not shelter him.

Rosty's Style

Dan Rostenkowski inherited a committee riven by partisan conflicts. The 1980 elections diminished the Democratic majority in the House, gave the Republicans control of the Senate for the first time in a generation, and placed Ronald Reagan in the White House. This lineup was not a prescription for bipartisan cooperation, especially since Reagan had campaigned on a platform to undo decades of Democratic policies. The Republicans were challenging the orthodox economics that had shaped tax legislation since the 1950s. With the Keynesian consensus crumbling, economics became a babble of conflicting theories, and members of Congress embraced different schools of thought. The Ways and Means Committee could count among its ranks representatives of most of those schools.

The schisms in economics mirrored the disarray in the economy. Two oil shocks, the coexistence of high inflation and high unemployment, and other economic ills had led to inconsistent government policies. Tax legislation had become more frequent and more contentious as taxpayer discontent, spurred by bracket creep — which raised the marginal and real tax rates of millions of Americans — spread from the states to Washington. Congress had to act, but there was little agreement on what should be done.

It was in this environment that the new chairman faced his first major challenge. During preliminary discussions on the 1981 tax legislation, which ultimately cut taxes by \$750 billion over five years, the White House flirted with the idea of negotiating a deal with Rostenkowski. But once the president fully committed himself to the conservative position on this issue, presidential aides rebuffed Rostenkowski's overtures, and he was forced to work in the same partisan manner that Ullman had preferred.

There were two big differences between the situations, however. Ullman dealt with a weak president of his own party; Rostenkowski had to reckon with a strong president of the opposing party. And unlike Ullman, Rostenkowski wanted to win. This consuming drive led him into a bidding war on the floor for the support of conservative "boll weevil" Democrats. He bargained, made concessions, and sweetened the tax cuts only to find that the Republicans had plucked off needed Democratic votes by outbidding him.

Rostenkowski learned what was already evident from his

predecessor's difficulties: trying to fashion a viable consensus limited to the Democrats on Ways and Means may not be sufficient to carry the day. This lesson was driven home in 1982 when Ways and Means Democrats rejected a revenue-raising package Rostenkowski had proposed.

What happened next is instructive for what the chairman did not do. He did not turn to committee Republicans in 1982. Instead, Rostenkowski decided that the key to winning was to deal with those Republicans who could deliver the votes. He let Senate Republicans take the initiative and then bargained with them (going directly to conference on the Senate-passed bill without first having the House consider the measure).

Since 1982 Rostenkowski has struck most of the big deals with the White House, and party differences on major policy issues have been bridged in several ways. The bipartisan Greenspan Commission was used to assemble the Social Security package in 1983. President Reagan endorsed the 1986 tax reform, which was then given a bipartisan tint in the chairman's "Write Rosty" campaign. The 1988 catastrophic insurance legislation was launched by the Republican secretary of health and human services, who skillfully maneuvered to obtain White House support and then looked somewhat favorably on efforts of congressional Democrats to sweeten the package.

Today the relationship of Ways and Means Democrats and Republicans falls somewhere between the consensus of the Mills regime and the partisanship of the Ullman years. Rostenkowski's ease with interpersonal matters enables him to harmonize relations with the Republicans. He knows that a generous word or a kind gesture can go a long way in getting people who disagree to share common legislative aims. He wants all members to share in the pride of being on Ways and Means. The committee's annual retreat brings Democrats and Republicans together in a relaxed atmosphere where they can discuss pressing public issues without being divided by pending legislation or public votes.

Taxes, however, remain a polarizing issue. No one on the committee can ignore the plain fact that the two parties often differ on tax matters or that the only way to resolve those differences is to make a deal with the White House. Taxation is special for yet another reason. It is the generic power of the committee, the source of all its other powers. After Ways and Means was forced to establish subcommittees, Ullman and Rostenkowski retained tax measures (except for minor ones) for the full committee.

Rostenkowski knows that the White House can usually deliver the necessary House Republican votes to close a deal on taxes, but he also knows that House Republicans cannot commit the White House. It is logical, therefore, for him to negotiate with the White House rather than with committee Republicans. This tactic almost backfired in 1985, however, when House Republicans voted against the rule that would have allowed floor consideration of the tax reform legislation. The Republicans resented being taken for granted by their own president and being ignored by the Democrats. Despite this resentment, a presidential trip

to Capitol Hill corralled sufficient Republican votes for adoption of the rule.

Bargaining with the White House suits the chairman's style and comports with his view that the country should be led by a strong president. Rostenkowski is from an older generation of legislators, comfortable with presidential leadership on important policy matters. But he also believes that Congress should not rubber-stamp presidential proposals. To him the 1986 tax reform legislation was a model of the proper roles and relationships of the two branches.

On other legislation, a more fluid relationship between committee Democrats and Republicans is possible. Republicans are often quite influential on matters considered in subcommittee. They had some success in getting their ideas into the committee bills on welfare reform, catastrophic health insurance, and the omnibus trade law. Nevertheless, Rostenkowski knows that in an era of divided government, the wrap-up deals can only be struck with the White House, and he is prepared to offer concessions to avoid a presidential veto.

New Tools of Leadership

Today's chairman cannot control Ways and Means the way Wilbur Mills once did. Yet he cannot afford to lose control. In his role as deal maker, he cannot obtain favorable terms or count on the committee to back up any agreement he reaches unless he bargains from strength.

Many of the instruments of power Mills wielded are unavailable to the current chairman, but new ones have taken their place. Three devices for leading the committee stand out: controlled decentralization of the committee, transition rules and other special provisions in omnibus legislation, and congressional budget procedures.

Controlled Decentralization

In contrast to Ullman, who permitted subcommittee chairmen to hire their own aides, Rostenkowski has reclaimed custody of most subcommittee staff. Recentralizing staff is an unmistakable message that the chairman runs the committee, but one should not leap to the conclusion that Rostenkowski has recaptured full control of the legislative agenda. Except for tax matters, much of the committee's legislative work is done by subcommittees and, as happens elsewhere, the full committee often makes only small adjustments before reporting a bill.

Despite their apparent autonomy, though, the subcommittees operate under what might be characterized as controlled decentralization. While each subcommittee proceeds on its own, there is considerable central guidance on the overall policy direction of the committee. The chairman delegates, but with the expectation that the subcommittee's product will be compatible with his general policy preferences, that it will abide by budget constraints, and that it will not cause political problems. If a subcommittee proceeds on this basis, it can fill in the details of legislation with a

relatively free hand and can expect the full committee to consider its recommendations positively.

Although they were not permanent subcommittees, the task forces Rostenkowski set up during the committee's work on tax reform in 1985 reflect his preferred mode of operation. He retained control of the big issues, such as the deductibility of state and local taxes. But within its assigned area, each task force had a great deal of discretion, provided that the total revenue impact of their recommendations was in line with the chairman's expectations.

Controlled decentralization is a compromise between concentrating power in the chairman and giving rank-and-file members a full voice in legislative policy. It is a compromise that has certain advantages. Delegating some of the details to subcommittees enables the chairman to avoid being fully implicated in them. After all, it is not always advantageous to be the person saying no or making the trade-offs. At the same time, keeping some distance from specific provisions gives the chairman and the committee room to maneuver if pressure builds to modify legislation recommended by the subcommittees.

Transition Rules

Still, the chairman cannot be totally oblivious to the fine print in legislation. Details are the stuff of legislative life. What might seem trivial to someone taking a grand look at

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policy might be very important to a particular member. Seemingly minor provisions can be especially significant when legislation parcels out losses.

An effective leader has to be able to offer inducements for the rank and file to cooperate. While journalists often rail against these side payments, they are essential in a well-functioning legislature. Dan Rostenkowski sees nothing wrong with side payments and is not inhibited about using them to bargain for support. As journalists Jeffrey Birnbaum and Alan Murray observed in *Showdown at Gucci Gulch*, he treated tax reform just "like any other tax bill. Deals had to be cut to keep the special interests from overwhelming the effort; votes had to be paid for with favors and special tax breaks." Rostenkowski is willing to pay a reasonable price for support and — perhaps even more important in cementing strong ties with committee members — he is willing to do a good turn for colleagues whose loyalty is already secure. If he asks for a colleague's support and gets it, that person will be remembered when the final details of the legislation are settled. If he asks for it and is turned down, that person will learn that the chairman keeps score.

The chairman has two resources at his command: general provisions that apply to a class of people affected by the legislation, and narrowly drawn provisions affecting only a few people. If they provide benefits, the general rules can be quite costly and thus can be used only sparingly in a constrained budget environment. Despite the bad press they get, narrow provisions, such as the "transition rules" provided in tax reform, have been favored in recent years. Originated to protect certain taxpayers who had acted on the basis of provisions in old tax laws against changes made in new legislation, these rules have been broadened to provide preferences to other taxpayers as well. They have largely replaced the "members' bills," which were common before the reforms of the 1970s.

Several advantages account for the extensive use of transition rules in tax legislation. First, by packaging them with broader legislation, a direct connection is made between supporting the measure and obtaining the relief. Second, transition rules and similar special provisions are typically controlled by the chairman; he decides who gets them. Third, the total cost of these provisions can be tallied and assessed in the light of the overall legislation in which they are placed. Thus many supporters of tax reform considered the estimated \$10 billion cost of transition rules provided in the bill a reasonable price to pay for the major benefits that were enacted.

Congressional Budget Procedures

During the 1970s congressional reform was not the only challenge to the old ways. Congress also established a new budget process that had the potential to weaken the Ways and Means hegemony in tax policy and other budget-related legislation. The question left unsettled by the bare terms of the 1974 budget reform act was whether the new

budget committees would ally with the tax-writing committees or rival them for legislative power.

In the late 1970s the budget committees did indeed seek greater influence in tax legislation, but they were strongly resisted by the Senate Finance Committee which had the most to lose from interference with its traditional role. The Senate has significantly changed its approach to tax (and other) legislation in the 1980s — and in the process simplified the task the Ways and Means Committee faces each time it must write tax and spending legislation to fit the confines of congressional budget decisions.

Ways and Means has learned how to live with budget constraints, such as reconciliation instructions, and it has even learned how to exploit the process to its advantage. The committee knows that it cannot be indifferent to the budget deficit and the recurring pressures for tax increases and spending cutbacks. In 1985 it legislated tax reform under the principle of revenue neutrality, and in 1988 it legislated an expansion of Medicare under the principle that the potential beneficiaries of catastrophic health insurance should bear the full cost of the new protections. It moderated the scope of welfare reform to fit presidential and other demands for a low-cost approach. Half a dozen times in the decade it responded to reconciliation instructions with legislation meeting the prescribed targets. Although the committee has tended in recent years to meet targets through bookkeeping adjustments and similar tactics, one cannot deny its official fidelity to the budget constraints imposed on it.

These constraints have significantly enhanced the chairman's leadership capacity in the committee and in Congress. The chairman has the lead role in defining reachable reconciliation targets for his committee, and the need to respond to those targets, or to limit the cost of new legislation to acceptable amounts, boosts his control of the committee. The chairman, moreover, is the dominant House negotiator in hammering out the specifics of the legislation with the Senate. While it is not new for tax legislation to be "written in conference," this practice seems to have spread to the full range of Ways and Means legislation.

Successful leadership of the Ways and Means Committee requires a personal style suitable to the times. Mills, Ullman, and Rostenkowski had very different styles, but they also presided under very different conditions. Near the end of his career, Wilbur Mills found that the role he had so effectively played for almost two decades was out of step with the House's yearning for individualism. Al Ullman tried with only limited success to find an appropriate niche for a chairman who had to lead without imposing his will on the committee or the House. Dan Rostenkowski has managed to find a balance, walking a line between being a chairman who takes charge and one who lets members develop their own legislative reputations and track records. Observers may be thankful that the House has itself returned to a more balanced view of the relationship between institutional effectiveness and individual self-expression.

Third World Debt: Phase Three Begins

Edward R. Fried and Philip H. Trezise

The announcement on July 23 of a debt agreement between Mexico and representatives of 500 creditor commercial banks from industrial countries has given operative meaning to a new phase in the long-running drama of Third World debt. Henceforth, strategy for dealing with the most heavily burdened Third World debtors will include officially sponsored reductions in the outstanding claims of private foreign lenders. This break with past policy is controversial. The prospects that it will speed a resolution of the debt problem are uncertain. It was also foreordained by events.

Birth of the Brady Plan

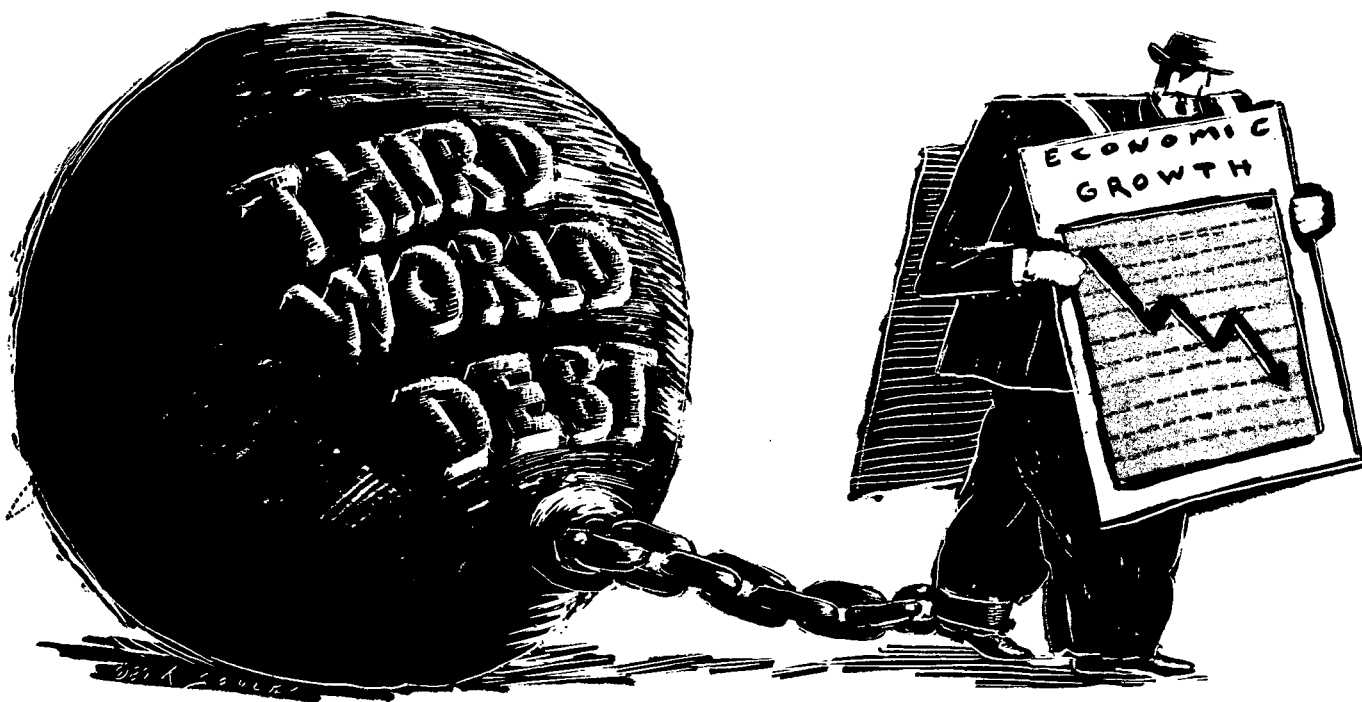
Third World debt turned into a crisis in August 1982, when Mexico stated that it could no longer meet current obligations to its foreign creditors. The response, under the leadership of the International Monetary Fund (IMF), was prompt and in its way effective. It emphasized austerity — cutbacks in imports and domestic investment — as a means of bringing debtors' external accounts under control. The principal creditor banks cooperated by making new loans, which on a net basis came to 90 percent of the interest

payments on outstanding loans. Any immediate threats of massive defaults and global financial panic were averted, and many, though by no means all, of the banks had begun to build satisfactory reserves against potential losses on their loans to Third World nations.

By 1985, however, the virtues of the austerity approach had been exhausted. A second stage of debt strategy was ushered in by then-Treasury Secretary James Baker, who called for renewed economic growth based on policy reforms in debtor nations. That growth was to be supported by increased lending by the World Bank and the regional development banks, together with \$6–\$7 billion a year in net new lending by commercial banks. The Baker plan subsequently came to include the encouragement of market-based financing options such as debt-equity swaps and the exchange of old bank debt for new bonds that reflected in some degree the discounts prevailing in secondary markets. What it did not do was to offer official financial support for the reduction of debt.

Baker's focus on economic growth obviously was right. Continuously depressed economies could not be expected to make debt servicing more feasible but would surely make life harder for a majority of the citizens of the indebted nations. And if growth was to be renewed, policy changes appeared to be required. Baker's basic prescription was for greater reliance on market forces, domestically and in foreign economic policy, and to a considerable extent debtor country governments accepted this approach. The Baker plan's chief shortcoming was in its assumption about new private financing.

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Lending by the World Bank and the regional development banks to the heavily indebted middle-income countries — the Baker 15* — in 1985–87 somewhat exceeded 1982–84 levels and ran well ahead of interest payments on the outstanding debt owed to these institutions. Net commercial bank lending, projected at \$18–\$21 billion for the 1986–88 period, proved in the final accounting to have been a negative \$2 billion. Moreover, the new lending that did take place in 1987–88 was concentrated on package loans for Argentina, Brazil, and Mexico. Smaller debtors that had put promising economic policy measures into effect — notably Chile, the Philippines, and Morocco — were unable to get new commercial bank credit.

Thus a new administration in Washington came into office in 1989 with all indications suggesting that a return to large-scale voluntary lending to Third World countries was far in the future. The U.S. government, after having resolutely resisted all proposals for writing down debt principal or easing the terms of outstanding loans, now found it necessary to look at a reduction in debt-servicing burdens as a live policy choice.

A reexamination of debt strategy was made more urgent by deteriorating economic and political conditions

throughout Latin America. Former Under Secretary of State William D. Rogers has characterized the mood in Latin America today as one of “desperation.” As real living standards have declined, the political future of the region’s present or prospective democracies has been put in question. Twelve presidential elections have been scheduled in Latin America in 1989–90. The first, in Argentina, was won by Carlos Menem of the populist Peronist party. In March 1989 riots rocked Venezuela’s new administration, headed by the much-respected Carlos Andres Perez, when it reduced government subsidies as a part of an economic reform package negotiated with the IMF. Mexico’s Partido Revolucionario Institucional (PRI) has serious political opposition for the first time in half a century, and its leader, Carlos Salinas de Gortari, clearly depends on external help to sustain his administration’s program of structural reform.

Rightly or wrongly, the burden of servicing foreign debts is considered within the region to be the principal reason for Latin America’s economic woes. That conviction has made the debt problem a potentially destabilizing political force, something that no government in Washington could view with other than deep concern.

It was against this background that Treasury Secretary Nicholas Brady announced on March 10 that the United States was prepared to support debt reduction as an integral part of ongoing debt strategy. His statement, made at a Brookings — Bretton Woods Committee conference, stressed that the Treasury had consulted widely with other creditor nations, the debtors, the multilateral institutions,

*Secretary Baker’s list consisted of Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, the Ivory Coast, Mexico, Morocco, Nigeria, Peru, the Philippines, Uruguay, Venezuela, and Yugoslavia. The World Bank’s category of heavily indebted middle-income countries adds Costa Rica and Jamaica.

the commercial banks, and members of Congress. At the same time, the initiative was American. Soon after Brady's speech, the Group of 7 industrial nations, whose banks hold most of the debt, endorsed the strategy (though not without reservations on the part of some members), as did the key IMF and World Bank committees.

Dimensions of the Debt

When the Brady plan was unveiled, the total of Third World debt seemed to have settled at \$1.3 trillion — about 50 percent of the combined gross national product (GNP) of the debtor nations. Adjusted for inflation, the debt was about 25 percent larger than it had been at the onset of the crisis in 1982.

These large magnitudes overstate the size of the problem that the Brady initiative is intended to address.

- Some 12 percent, or \$150 billion of the \$1.3 trillion, is short-term trade finance, which normally is rolled over without difficulty.

- Another 5 percent is owed by low-income sub-Saharan African countries, which are dependent on concessional capital from industrial country governments and the multilateral financial agencies. Governments belonging to the Organization for Economic Cooperation and Development (OECD) are rescheduling or writing off these loans, or reducing interest rates on them, to encourage policy reform and recovery programs. Private banks are not a factor here.

- Roughly 46 percent of outstanding long-term debt is owed by some 50 countries, whose debt, on the whole, seems manageable. There are trouble spots and reschedulings in this group, but interest payments average a reasonable 7 percent of exports of goods and services. OECD governments are either the creditors or guarantors of 60 percent of this debt; private banks are at risk for 40

percent and continue to be voluntary suppliers of new money to some of these countries.

- The 17 highly indebted middle-income countries account for the remaining 37 percent, or \$480 billion in medium- and long-term debt. They are the object of the Brady initiative, as they were of predecessor programs. Private banks hold 58 percent of this debt, or about \$280 billion. Multilateral banks, the IMF, and OECD governments hold the rest. Four-fifths is concentrated in Latin America, heavily so in Brazil, Mexico, Argentina, and Venezuela. Economic and debt difficulties among the 17 are severe. In 1988 interest obligations averaged 25 percent of exports of goods and services and 4 percent of combined GNP. Investment is still depressed: 15 percent of GNP in 1988 compared with 25 percent in 1980. A large net outflow of resources continues, and economic growth in 1987–88 was under 2 percent, less than population growth. In 1988 per capita consumption for the group as a whole was 5 percent lower than it was at the beginning of the decade.

Elements of the Brady Plan

How does the Brady plan propose to deal with this rather bleak picture?

Sensibly, the new strategy builds on rather than replaces the essential features of the Baker plan. It recognizes that a favorable resolution of the debt problem requires higher economic growth, which in turn depends on economic policy reforms designed to use resources more efficiently, encourage domestic savings and investment, and attract capital from abroad, including the repatriation of flight capital. The World Bank and the IMF, supported by the regional development banks, continue to have the central responsibility for promoting structural improvements in the debtor countries. As before, the approach is case by case rather than comprehensive, with external financing from these institutions, private banks, and governments tied to policy performance.

The Brady initiative represents change mainly in offering for the first time financial support from the international institutions and the government of Japan for negotiated reductions in debt and debt service. Voluntary or market-based debt reduction had already been part of the menu approach under the Baker plan. Indeed, in 1988 the highly indebted countries, principally Mexico, Brazil, and Chile, had extinguished approximately \$15 billion in commercial bank debt (an increase from \$8 billion in 1987) through debt-for-equity swaps, debt-for-debt exchanges, and debt buybacks. While an increase in the volume of these transactions is an objective of the Brady plan, the new strategy does not rely solely on market-based arrangements.

Now the World Bank and the IMF are to make loans expressly to enable debtor governments to negotiate debt-reduction transactions with the commercial banks. With these funds available as collateral, the debtors can offer to exchange their debt to commercial banks at a discount for new bonds or at par for bonds carrying reduced rates of

"Now the World Bank and the IMF are to make loans expressly to enable debtor governments to negotiate debt-reduction transactions with the commercial banks."

interest, or combinations of both. Or they can use the funds to buy back their bank debt at a discount for cash. In a significant departure from earlier practice, the debtor governments may be given assurance of World Bank and IMF lending before they reach agreement on what the commercial banks are willing to do, a step that would give them needed help more expeditiously and could also strengthen their bargaining position with the commercial banks.

Operational guidelines subsequently worked out by the World Bank and the IMF indicate that some \$22 billion will be available over three years to support debt reduction through so-called credit enhancements (guarantees), roughly half from each institution. Of this total, \$11 billion could be used to support negotiated reductions in interest payments. These funds would be additional to loans that the two institutions would otherwise be prepared to extend. The remainder, approximately half the total, could be used to support negotiated reductions of debt principal. This latter portion falls within ongoing lending guidelines and in this sense probably would not be additional. Terms of individual transactions negotiated by the debtor countries with the commercial banks will be subject to the approval of the lending institutions — that is, the World Bank and the IMF — which should add to the negotiating leverage of the countries and help to ensure that the transactions are an efficient use of scarce financial resources.

World Bank and IMF lending for debt reduction is limited to debt-distressed countries committed to structural adjustment and policy reform, a proviso that will tend to limit the number of eligible debtor countries. To facilitate quick negotiations, the Brady plan asks the commercial banks to provide temporary general waivers to the sharing and negative pledge clauses* in their existing loan agreements with countries negotiating debt-reduction agreements. The banks are also counted on to continue project loans and lending for trade finance and to participate in concerted new lending packages. For their part, debtor countries are expected to maintain viable debt-equity swap programs as an additional means of reducing debt-service burdens and promoting investment.

In support of this new approach, Japan announced that it would commit \$4.5 billion over the next three years for additional lending by its Export-Import Bank in parallel

with IMF lending to the highly indebted countries and has since agreed to provide another \$5.5 billion, presumably for lending in parallel with World Bank programs. The three-year totals for support of debt reduction are therefore on the order of \$32 billion, or nearly \$11 billion a year.

The Plan's Potential

How far can the Brady plan's resources go toward achieving an orderly resolution of the debt problem or, more to the point, toward promoting the stronger economic growth upon which an orderly debt resolution will ultimately depend?

Projections by the IMF staff show that continued adjustment efforts on the part of the debtor countries in a reasonably favorable external environment could raise GNP growth to 4 percent a year, or double the 1988 figure, in three to five years. More specifically, World Bank studies suggest that GNP growth in these countries could reach 4–5 percent a year over the next few years, depending on further improvements in the efficiency of resource use and a net inflow of some \$20 billion a year in medium- and long-term capital from all sources: direct foreign investment, bilateral governmental aid and credits, loans from the multilateral development banks and the IMF, and new lending from the commercial banks. Short-term credits adequate to finance trade are taken as given.

In both analyses, the link between domestic economic policy and capital inflows is seen as crucial. On the one hand, economic reform programs can be exploited fully only if they are supported by a significant improvement in capital flows. On the other, inflows of capital will depend on the vigor with which economic reform is being pursued.

Of the \$20 billion in needed capital inflows projected by the World Bank, \$13 billion seems attainable with good policy performance. The critical portion is the \$7 billion or so attributed to new commercial bank loans. From recent experience, however, new lending on this order seems to be out of the question. Nor can the shortfall be made up elsewhere. For the international financial institutions to seek to do so would quickly overwhelm their lending capacity, if not their credit standing. Furthermore, such a shift in debt liabilities from private to public sources would be difficult to justify and, at this time at least, would not get the approval of OECD governments.

This was the dilemma the Brady initiative sought to address. New medium- and long-term bank lending of \$7 billion a year represents about one-third of the interest payments due the banks on their outstanding loans to the highly indebted countries. It follows, therefore, that a negotiated reduction of one-third in debt principal or interest rates would have the same effect as \$7 billion a year in new lending, with the added political bonus that debt reduction could provide to the governments of the hard-pressed debtor countries.

Measured against this standard, the \$32 billion or so available to support debt reduction under the Brady initiative seems to be too small. For example, if the total

*These clauses are individually specified in loan agreements. Generally, negative pledges obligate borrowers *not* to pledge assets or future earnings to one creditor to the prejudice of other creditors. Sharing clauses require borrowers, when meeting payment obligations, to share assets and earnings proportionately among all participating creditors. A borrowing country may have several hundred bank creditors with differing interests and preferences about the form of debt reduction and the size of the discount. Therefore, obtaining individual waivers of these claims in order to complete a debt-reduction transaction could be a difficult and prolonged process.

amount were used to guarantee new bonds issued in exchange for outstanding debt at a discount of 50 percent, the total commercial bank debt would be reduced by \$64 billion, or almost one-fourth. Total debt, however, would be reduced by only half this amount, since the additional debt owed to the IMF, the World Bank, and Japan would replace half the commercial bank debt that had been retired. The same result would apply to a buyback of bonds for cash. The potential savings in debt-servicing payments would amount to \$3.2 billion a year (that is, assuming an interest rate of 10 percent on a net retirement of \$32 billion in debt). That would be equal to about 45 percent of the new lending needed from the banks. Even this result, moreover, would be attained only over several years.

These calculations apply to the category of highly indebted countries as a whole, only some of which are close to meeting the policy performance requirements that are likely to be applied by the Bank and the IMF. Thus proportionately larger amounts for debt and interest rate reductions could be allocated to countries further along in their restructuring — Mexico, the Philippines, Costa Rica, and Venezuela — but the general financial limitations on the program would still apply.

It is "simple arithmetic," as Paul Volcker has remarked, that in terms of immediate cash flow, a given amount of new money equals 10 times that amount of debt reduction. That is because the first-year contribution of the latter is limited to the savings on interest (at the assumed 10 percent

Alternatives to the Brady Plan

The Brady plan has its critics, both among those who see it as giving official blessing to borrowers unwilling to make the effort to pay and those who find it too timid an approach to the problem of insupportable debt burdens. Were credible alternatives available?

At one extreme, the OECD governments could simply have taken a hands-off position. In that case, the creditor banks could be expected to intensify efforts to reduce their exposure — a policy that had served reasonably well when choices were limited to damage control. Capital positions had desperately needed strengthening, and wide differences in the interests and strategies of the many banks involved had inevitably led to lowest-common-denominator agreements with debtor governments.

This approach has reached the end of its road, for political as well as economic reasons. Arrearages of all countries encountering debt-servicing difficulties total \$11 billion. Failure to cooperate with the performing debtor countries would almost surely worsen their prospects, leading to steady if not rapid increases in arrearages and to a further fall in the value of bank claims (which still represent almost 60 percent of the external debt of these countries). It is not easy to see how a hands-off policy could be in the

short-, medium-, or long-term interests of any of the parties, the commercial banks included.

At the other end of the spectrum is the idea, which has many proponents, of establishing some form of international authority to buy up debt on a selective or comprehensive basis at discounts prevailing in secondary markets and to relend to the debtors at these discounts. In most versions these debt buybacks would be conditional on economic reform programs in the debtor countries, to be monitored by the debt-management body. Henry Kaufman, the investment banker, has argued that Third World debt will have to be "socialized"; the debt-buyback proposals would do that.

It cannot be ruled out that something of this sort may ultimately be necessary. For the present, the obstacles are redoubtable. A debt-management authority would have to have funding from industrial country governments to buy up debt; some would be up-front money, the rest in much larger contingent liabilities against defaults by debtor countries on their discounted loans. The OECD governments have made clear that they are not willing to have the responsibility for these liabilities transferred to them from the banks.

Advocates of the buyback approach contend that it would be costless if the

discounts were right. That assumes, however, that markets would forecast accurately how successful the debtor countries would be in achieving the growth necessary to service their reduced debt. Moreover, the creditor banks, dispersed among the OECD countries, would have to be induced or forced to sell and write off their claims now — this in the face of the disparate tax and legal situations that obtain and the differences among the banks in judgments about their short- and longer-term interests.

The Brady plan falls between these extremes. It maintains the cooperative stance of linked responsibilities among debtor countries, banks, international institutions, and OECD governments that has characterized debt strategy since 1982. Official financial support for debt reduction not only expands the menu of voluntary options elaborated under the Baker initiative, but it also gives the IMF and the World Bank powerful new means for encouraging debtor countries to reform their economic policies. This financial support in fact represents a limited, indirect acceptance by OECD governments of contingent liability for Third World debt, the difference being that for these governments the liability flows from shared commitments in the international institutions supplying the funds.

rate). Thus, if ways can be found to induce sufficient new lending in combination with reduced debt, the reach of the Brady plan could extend further. But the secondary markets have put a weighted average discount of 60 percent on the commercial bank debt of the highly indebted countries. In other words, new loans put on a bank's books at par would have a present market value of 40 percent of par, which would discourage new lending commitments. In presenting his plan, Secretary Brady mentioned, presumably in this connection, that "consideration could be given in some cases to ways of differentiating new from old debt." Whether such a distinction could be made in the tangled political, legal, and administrative environment of Third World debt remains to be seen.

Repatriation of flight capital is another possible source of funds. The potential is very large; capital amounting to as much as 50 percent of outstanding debt may have moved abroad during this decade. But as Barber Conable, president of the World Bank, has observed, capital cannot be ordered back; it moves toward favorable economic environments and away from unfavorable ones. Once policy improvements are put into place and recovery is under way, flight capital is likely to be repatriated. Thus it could be a sizable, cumulative positive factor in the medium term. In the short term, however, some front-loading of other capital inflows will be needed; otherwise net outflows of resources could stymie the very recovery process needed to bring flight capital home.

The question, then, is how to get the optimum up-front reduction in debt-service payments. Given the limited amounts that are to be available from the IMF, the World Bank, and Japan, leveraging their use over the next several years becomes a critical variable. One obvious strategy would be to keep the period covered by guarantees as brief as possible, while still providing demonstrable benefits to debtors and creditors alike.

Suppose, for example, that long-term bonds used to replace a debtor nation's existing bank debt would carry an interest rate at 50 percent of the original rate for the first five years, with an explicit understanding that after the fifth year the rate would be negotiated in light of the country's progress toward creditworthiness or, in some cases, the course of world prices for its principal export commodities. IMF or World Bank funds committed to guaranteeing payment of the lowered rate for short periods would go much further than if the guarantee provision were extended to the maturity of the bond. Thus the Brady initiative's potential for debt relief in the short term would be the larger — and the need for new commercial bank lending the smaller. In these circumstances, moreover, the creditor banks could defer the issue of a write-off of debt principal. Meanwhile their interest income during the initial period would be reduced but also ensured, and the risk of added arrearages would be avoided.

Similar considerations apply to guarantees of reduced debt principal. The shorter the time during which guarantees are to be effective, the greater the up-front leverage to be gained from the use of the funds available for debt

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reduction. It is important to recognize that maximum relief for eligible debtors over the next few years could be critical to success.

Secretary Brady presented his debt strategy within six weeks of President Bush's inauguration. Fourteen weeks later the main outlines of a debt-reduction agreement between Mexico and its creditor private banks was announced. Given the complexities of the negotiation and the initial positions of the parties, this arrangement is an impressive accomplishment. It may or may not be an infallibly favorable omen for the Brady plan's future, but it does demonstrate that the new strategy has substantial driving force behind it.

First Test: The Mexican Agreement

From the beginning, Mexico seemed the likely first test of the Brady plan. Mexico's external debt of \$107 billion is exceeded only by that of Brazil; \$53 billion is medium- and long-term debt to foreign banks. Net transfers abroad had been running at about 6 percent of GNP, giving Mexico a severe cash flow problem. At the same time, the country since 1983 has pursued, at much domestic pain and risk, an economic reform program under which some of the sacred cows of the ruling PRI have been sacrificed — state enterprises have been privatized, foreign direct investment has been encouraged, protective tariffs have been slashed, and membership in the General Agreement on Tariffs and Trade has been embraced (after four decades of hostility). The government cut public spending by 10 percent of GNP — the budget is now in balance — and in recent years a devalued peso has helped to raise non-oil exports sharply, by 16 percent in 1988.

Mexico sought to reduce its net transfers from 6 percent of GNP to 2 percent, or by roughly \$6–\$7 billion a year. This improvement in capital flows was seen as necessary to

raise Mexico's economic growth rate from the expected 1–1.5 percent this year to 4 percent in 1990. A substantial increase in lending from the multilateral financial institutions and Japan was assured. The critical component was the improvement in capital flows Mexico could obtain from its commercial bank creditors.

To this end, Mexico had to negotiate with a committee representing 500-odd banks whose claims are distributed widely among headquarters in the industrial countries and subject to differing tax and regulatory rules. (U.S. banks hold about 30 percent of the claims against Mexico, Japanese banks perhaps 20 percent, and subsidiaries of banks headquartered in Mexico itself more than 10 percent. European banks hold most of the rest.) Mexico's first offer to the commercial banks called for a reduction of \$4.5 billion a year in net transfers, to be obtained through a combination of debt and interest rate reductions and new lending. On debt reduction, Mexico sought discounts of 55 percent on outstanding medium- and long-term debt, about equal to the discounts for its debt prevailing in secondary markets. Alternatively, it asked for comparable reductions in interest rates on this debt, leaving the amounts at par.

If these concessions had been applied to the entire outstanding debt, the reduction in debt-service requirements would have amounted to some \$3 billion a year. Even then, Mexico's initial negotiating position would have required the commercial banks to lend an additional \$1.5 billion a year, presumably on the reckoning that with its debt servicing reduced sharply, Mexico would immediately become a reasonably attractive credit risk. The commercial creditor banks countered with an equally extreme position by offering concessions amounting to perhaps one-fourth of Mexico's request.

The eventual compromise, whose impact cannot be definitively calculated for several months, may provide Mexico with about two-thirds of what it asked for in debt reduction and perhaps half of its requested improvement in cash flow. The agreement offers the creditor banks several choices:

- They can take new 30-year bonds in exchange for existing debt at 65 percent of face value, with interest at the London Interbank Offering Rate plus $\frac{13}{16}$ percent.
- They can take new 30-year bonds at a fixed interest rate of 6.25 percent.
- Or they can provide new money over the next four years equal to 25 percent of their outstanding claims (which would amount to their financing about two-thirds of interest payments due to them).

Banks accepting the new debt- or interest-reduction bonds in exchange for old debt will have the interest guaranteed on a rolling basis for at least 18 months and as much as 24 months, and the principal secured by zero-coupon U.S. Treasury bonds. These "credit enhancements" will be financed by \$7 billion provided by the IMF, the World Bank, Japan, and Mexico. As a further incentive, the banks are promised an improvement of up to 3 percent in interest rates on the new bonds after 1996 if Mexican oil

revenues, adjusted for inflation, increase over 1989 revenues. Finally, Mexico agreed to permit debt-equity swaps up to a total of \$1 billion a year for three years.

Individual banks must choose among the three options by the end of the year. Until decisions are made, the impact of the agreement on Mexico's external debt, debt service, and cash flow will have to be a guess. The Mexican authorities estimated on the basis of a survey of very tentative views that 60 percent of the debt will be traded in for lower interest par bonds and 20 percent for reduced principal bonds, with a final 20 percent coming as new money. In relation to cash flow, that would be a consequential outcome. Payments of interest would be reduced on a net basis (i.e., after taking into account interest charges on the funds used to purchase the zero-coupon Treasury bonds to guarantee principal of the new bonds) by \$1.1 billion. New money would be in the order of \$650 million a year. Total cash-flow improvement then would average \$1.7 billion a year (netting out interest payments on the new money) over the four years of the agreement.

Suppose, however, that the Mexican view of likely bank choices is overly skewed toward the debt-reduction options. Some banks will indeed choose to take losses by accepting the greater security of the discounted or reduced-interest bonds. But others may have a brighter view of Mexico's economic outlook or will wish to avoid writing down debt. These banks may elect to add to their portfolios of Mexican debt even though the loans will not be subject to guarantees. In that event debt reduction will be smaller but cash flows larger over the next four years. For example, if new money were to be 50, rather than 20, percent of the total, the cash-flow benefit would average about \$2 billion a year.

An Initial Assessment

Compared with what Mexico initially requested, the agreement can be seen as less than attractive. Nor will it do much to reduce Mexico's debt overhang; indeed total debt would rise over the next four years if banks were to move strongly in favor of the new money option. But neither of these facts should be viewed as critical to judging the agreement. Mexico's beginning offer was clearly a negotiating position. Furthermore, the calculation of capital requirements reflected in the offer was made when the price of oil was lower and interest rates higher than they are now. The improvement in these prices in Mexico's favor since the beginning of 1989 could be equivalent to an annual capital inflow of \$1 billion or more.

As for the effect on the stock of debt, the key consideration is not the total debt but rather the interest that has to be paid on it. In this respect, the savings to Mexico of more than \$1 billion a year would be sizable. This reduction in debt and debt service would have been achieved, moreover, with a relatively modest amount of securitization. If Mexico's estimates are borne out, new bonds totaling \$38 billion will have as security only \$7 billion in collateral. To be sure, the discount of 55 percent on Mexican debt in

secondary markets is much larger than the 35 percent negotiated in the agreement. But the secondary-market discount applies to an all-cash transaction where the collateral would in effect be 100 percent of the discounted amount.

Mexico's prospective cash-flow improvement is by far the most important measure of the agreement. An additional \$1.7–\$2 billion a year in cash flow, if achieved proportionately in debt negotiations with the other highly indebted countries, would be equivalent to \$8–\$10 billion a year in new lending to the group as a whole. That is higher than the failed target for new lending sought under the Baker plan. It is also well in line with the amount the World Bank estimates is needed from the commercial banks to underwrite economic recovery.

It is not wrong, therefore, to say that the Brady plan has gotten off to a promising start. The commercial banks have been brought to a supportive rather than a negative role in Mexico's economic recovery program. Over the remainder of the year they will be observing Mexican developments and making their decisions accordingly. Early indicators have been encouraging: domestic interest rates have fallen sharply, and some flight capital has returned (the Salinas government has announced that it will give favorable tax treatment to repatriated funds). Political reaction in Mexico, moreover, has been strongly positive.

Agreement between Mexico and the banks was crucial for the Brady plan. A stalemate would have put much of the new strategy in question. Now that test has been passed. While other and probably more difficult cases are still to be tackled, the Mexican beginning may be a favorable augury for them.

Within less than a month of the Mexican agreement, the Philippine government and its bankers were able to come to an understanding on a quite different basis. The banks agreed to support a Philippine bond issue in the international market — a test of the nation's creditworthiness.

"Agreement between Mexico and the banks was crucial for the Brady plan. A stalemate would have put much of the new strategy in question. Now that test has been passed."

Meanwhile, the government proposes to use cash reserves or borrowings from the IMF and the World Bank to buy at a discount in the secondary market some of the debt owed to foreign commercial banks. For Manila, with a relatively small bank debt, a successful reentry to world capital markets is a priority objective. For the Brady plan, the Philippine agreement is confirmation that the new strategy is a flexible strategy. Eventual agreements with Venezuela, Costa Rica, and other countries qualifying for negotiations are likely to affirm this point.

Still down the road are Brazil and Argentina, which together account for one-third of the troubled debt. Whether and when these large debtors will have met the conditions for a Brady plan type of negotiation will depend on political and economic developments that have yet to unfold. What can be said is that the new governments in Brasilia and Buenos Aires are bound to be influenced by events in Mexico.

In judging the Brady plan, several factors should be remembered. First, the objective is not to wipe out or even necessarily to reduce the stock of debt but rather to bring debt-service burdens down to a point consistent with sustainable growth. Federal Deposit Insurance Corporation studies suggest that the major debtors are able to service about two-thirds of their present debt. That is consistent with the fact that a reduction of one-third in interest payments would reduce the ratio to GNP to where it was 10 years ago, when economic growth averaged over 4 percent. Ten years ago, however, the debtor countries were receiving large capital inflows; now, of course, they must rely more heavily on mobilizing domestic savings.

Second, the next five years are likely to be critical to success. Front loading of debt-reduction transactions and new lending are very important to an economic turnaround. If the turnaround can be accomplished, a gradual decline in total debt and a more rapid improvement in debt-service ratios are clearly possible. A return to full creditworthiness might not be far behind.

Third, the political and economic structures of the debtor countries are far from uniform, and the financial requirements to support debt reduction and new lending will be lumpy. The Brady plan may well be underfunded in relation to the total problem but still be adequate for the near term. Genuine progress now, based on using available resources early, should have positive demonstration effects for lagging countries. If additional financing turns out to be needed, the evidence that success is possible will make easier the job of finding the resources.

Finally, cooperation among and on the part of the commercial banks will be an indispensable ingredient. The essence of a cooperative strategy is that no major participant can hang back in the expectation that others will make up the shortfall. In view of the difficult and complicated circumstances in which banks must make their decisions, they could end up doing too little, too late, to protect their huge investment. If so, regulatory inducements and official pressures will be necessary. Otherwise, the Brady strategy and much more will be at risk.

Pacific Rim Economic Cooperation: Some ASEAN Perspectives

David Malone, recently a guest scholar at Brookings, is a member of the Canadian Foreign Service. He has just returned from traveling to several ASEAN countries. The views expressed in this article are his own and not necessarily those of his government.

Advocacy of new mechanisms to enhance regional economic cooperation among Pacific Rim countries has turned into a growth industry within policy circles on both sides of the Pacific. A recent proposal for a new regional economic forum was offered in January 1989 by Australian Prime Minister Bob Hawke, and a ministerial-level meeting is now expected to take place in Canberra in November to discuss the issue further. This meeting warrants close attention for the insights it will provide into the nature of future economic and trade policy cooperation among the Pacific Rim nations.

Critical to the shape of any Pacific economic cooperation are the countries of the Association of Southeast Asian Nations (ASEAN). Of the world's 10 fastest growing economies, four — Singapore, Thailand, Malaysia and the Philippines — belong to ASEAN. (The other ASEAN members are Brunei and Indonesia.) During the last four years, ASEAN countries have increased their share of world trade from 2 percent to 4 percent, a figure projected to double again over the next four years. These countries form a link between North Asia and the South Pacific economies of Australia and New Zealand. Furthermore, as neighbors of Indochina and the People's Republic of China, and as the crossroads of Asia, they are important geopolitically.

For these reasons, meaningful cooperation in the Pacific Rim will not occur without ASEAN participation. Yet recent discussions with knowledgeable parties in several ASEAN countries indicate that their governments are ambivalent about the concept. Thus the success of any cooperative effort will depend a great deal on how well its advocates deal with ASEAN's concerns.

The Proposals

Hawke's proposal is catalyzing the debate in the region. The prime minister called for enhanced regional cooperation within a new forum to, first, help press forward the Uruguay Round of negotiations on GATT (General Agreement on Tariffs and Trade); second, discuss obstacles to trade within the region; and third, foster economic policy cooperation in the area. The prime minister suggested that the Organization for Economic Cooperation and Development (OECD) could provide a model of sorts for the forum.

Hawke's is one of many proposals for greater Pacific cooperation, several of which have come from Americans. In 1988 Secretary of State George Shultz suggested trans-Pacific cooperation on security as well as economic issues. Since then Senators Bill Bradley and Alan Cranston, among others, have issued their own initiatives.

James Baker, George Bush's secretary of state, announced on June 26, 1989, his intention to explore with ASEAN leaders the creation of a new mechanism for multilateral economic and trade cooperation in the Pacific region. Although some news reports suggested that Baker's proposal might compete with Hawke's, nothing in the

secretary's speech suggests any real incompatibility between the two men. Indeed, specifics were left for later. As a result, attention has continued to focus on the Hawke proposal.

Range of Concerns

Concerns in the ASEAN countries about greater economic cooperation in general and the Hawke proposal in particular cover a broad spectrum from the general to the specific, from who will play to what the game will be. One frequently raised question is what precisely is meant by the term economic cooperation. International economic policy coordination does not have a good name in ASEAN, not only because it has had mixed success among the Group of 7 industrialized democracies, but also because it is seen as a cover for U.S. pressures on dynamic Asian economies to liberalize their trade practices and exchange rate policies.

In some quarters, it is thought that the United States might seek to incorporate defense and security considerations into what Hawke is promoting as an economic institution. Others are not enthused by the potential of using OECD as a model, viewing it as a locus for the kinds of effete discussions of

social policy that have led to a decline of Western dynamism relative to that of East Asia.

Among some circles, the need for a new cooperative organization is questioned. One view holds that the economic development of the area is proceeding swimmingly and that there is no reason to argue with success. That view might change if Japan comes up with a "Santa Claus" package as an incentive to set up the new forum.

Fast-breaking geopolitical changes in the area, particularly in Indochina, suggest to others that now is not a good time for new institutions. A strong ASEAN is seen to inhibit both China and the Soviet Union.

Potential Players

The forum's proposed composition also poses problems to some. A forum that is dominated by Japan and/or the United States is a frightening prospect; some in the ASEAN area are worried about renewed designs in Tokyo, particularly in the Ministry of International Trade and Industry (MITI), for "co-prosperity" in Asia.

Even before the events of Tiananmen Square, the proposed membership of China, Taiwan, and Hong Kong was being questioned as being more than a new institution could handle. None of the three may be invited to the November meeting. Another uncertainty is how to deal with the Soviet Union and Latin American nations if these Pacific Rim actors express interest in joining. Such issues raise questions about how coherent a group might eventually emerge.

Institutional Issues

Beyond concerns about membership, there is a real fear that a forum for regional economic cooperation would undermine ASEAN. Through annual ministerial-level consultations with the United States, Japan, the European Community (EC), and Canada, the association now gives its members a profile in the world that far outstrips what bilateral ties with the major economic powers would warrant. ASEAN has become a geopolitical unit to be

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reckoned with, and to some extent it counterbalances the weight of China and Japan, a significant achievement for nations living in the shadow of those giants.

There is also palpable concern about the role the forum might play. Some ambiguity in discussions on the Hawke initiative has left the impression that the eventual goal is the establishment of a trading bloc along the lines of the EC's integrated market or the Free Trade Agreement binding Canada and the United States — notwithstanding Hawke's clear statement that this should not be the case. While the prospect of a trading bloc is greeted with enthusiasm in some ASEAN circles, uncertainty over what actually is intended for the forum has led to fears elsewhere that it could undermine the Uruguay Round.

Those in favor of a trade bloc contend that a forum dedicated only to consultations on trade and economic questions will simply waste time, money, and effort. (The waste of time and effort might be counterbalanced if the organization is able to blunt U.S. protectionism, but that is thought to be unlikely.)

If the forum is to be merely consultative, many ASEAN researchers believe it should be nongovernmental or

at least not exclusively governmental. The existing Pacific Economic Cooperation Council is often mentioned as a useful and increasingly professional institution bringing together governments, academics, and private sector representatives on regional issues. Early thoughts of marrying Hawke's ideas with the council's existing capabilities seem to have faded over the months, however.

There are other institutional concerns. A new forum would require a secretariat. Secretariats cost money. The smaller bureaucracies in the area, moreover, might have trouble coping with the demands of yet another international organization — a concern noted even in New Zealand.

Domestic Worries

Last but not least are concerns about the forum's potential effect on domestic policies. Could the United States, for example, use the forum to target ASEAN members for unfair trade practices under the so-called Super 301 provisions? While the likelihood of that happening may seem remote in Washington, concerns on this score run high in Thailand. Alternatively, or simultaneously, the United States could use the forum to exert pressure on exchange rate questions. If that were to happen, would pressure for further disciplines on export financing be far behind?

Multilateral economic organizations bring to mind mainly the International Monetary Fund and the World Bank, which in turn evoke thoughts of structural and policy adjustment. While some ASEAN economies, such as Singapore, are highly flexible, others, like the Philippines, are not. What would a multilateral regional forum be pressing ASEAN countries to do? Will the forum create an opportunity for an independent secretariat and other members to scrutinize and criticize domestic economic policies?

A Pacific OECD?

Not surprisingly, the concern that a forum along the lines of the OECD might provoke unwelcome scrutiny of domestic economic, trade, and social

policies was mentioned only by researchers and other nongovernment interlocutors who have little sympathy with the wish of governments to protect themselves. The weight of this concern relative to the others should not be exaggerated. It is striking, nonetheless, simply because it is often not expressed at all.

ASEAN concerns about setting up an OECD-style forum are easy to overlook because the Hawke initiative has generated more discussion among the industrialized governments involved about who should play than about what the game should be. While ASEAN countries have views on who should participate in any cooperative effort — and these vary — they feel that there should be more to the examination of the initiative than its proposed membership. Having received few answers to their substantive questions along these lines by the time of the July ASEAN meeting, it is hardly surprising that they refused to sign on to the team. To them, the Hawke proposal is not just another “process” initiative.

It is no coincidence that the ASEAN Secretariat is weak. ASEAN researchers confirm that member governments want it that way. All internal efforts aimed at strengthening the economic capabilities of the secretariat have been emasculated by its members. The availability of data, or lack thereof, in the ASEAN countries is a related issue. Research institutions within these countries have great difficulty in obtaining the type of data they would need to formulate authoritative policy prescriptions.

Governments in Asia are acutely aware of the type of analysis the OECD Secretariat produces in large quantities not only on the world economy in general but also on member countries. They know that these findings are publicized. That is one of the reasons references to a Pacific OECD are not particularly welcome to many in Asia. Governments know that their ability to inhibit criticism from domestic research facilities could probably not be duplicated in a multilateral research and policy organization that included Western countries used to criticism of their own policies.

The OECD evolved from a unique set of circumstances dating back to World War II, the Marshall Plan, and the Organization for European Economic Cooperation. If the OECD did not exist today, its members might not be moved to invent it. Members have grown accustomed to the OECD's brand of polite criticism and prescription (on an often bewildering range of issues) over the years. Liberal democracies, frequently under pressure to adopt more “accommodating” policies, can and do make use of OECD findings and advice when adopting necessary but unpopular measures. Governments have also learned to ignore the OECD when it suits them to do so.

To governments in the developing world, however, even those of ASEAN, the OECD experience must look quite risky and potentially painful. Policy advice on issues considered highly sensitive by ASEAN governments is clearly unwelcome unless very gingerly (and privately) tendered — as is mostly the case for recommendations made by the IMF, World Bank, and Asian Development Bank.

Indeed, the lack of enthusiasm shown by several ASEAN countries toward efforts by the OECD to draw them into a structured dialogue on issues of mutual relevance suggests

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that the OECD will have to work harder to convince these governments that its brand of research and policy work is of potential value to them — rather than of potential danger.

More broadly, ASEAN attitudes indicate that these countries might be more comfortable with a consultative (and hence less effective) forum than with a strong international institution backed by an authoritative secretariat. This is why the Pacific Economic Cooperation Council is often mentioned as a model in the ASEAN area.

Other Sensibilities

Whatever one may think of ASEAN reservations about a strong regional agency to promote multilateral economic and trade cooperation, it will be important to remain sensitive to them. There are other sensibilities as well. EC protests over the Hawke proposal during the ASEAN meeting last July were understandable, given some continuing ambiguity over the forum as a possible new trade bloc. While not a major obstacle, the protests serve to remind that the creation of a new forum must be carefully managed.

An important unknown factor is the position of the Japanese government: MITI is said to favor the initiative, while others in Tokyo worry that it might complicate relations with Japan's Asian neighbors. However, given the caution traditionally displayed by Japan on multilateral institutional issues, it seems unlikely that Tokyo will play a lead role, at least initially, in developing a new forum or in strongly influencing the debate at the November meeting. (Former Prime Minister Nakasone's 1988 call for a Pacific forum to enhance economic and cultural cooperation in the area has not been followed up).

In sum, viewed from the ASEAN perspective, the Hawke initiative is not yet a done deal, and the prospect of genuine Pacific Rim economic cooperation raises uncomfortable questions. However, if ASEAN concerns are addressed satisfactorily at the November meeting, the ASEAN governments might yet agree to a forum down the line. The Canberra meeting will be worth watching closely.

Answering the Demo-Doomsayers

Five Myths About America's Demographic Future

Roger L. Conner

For the last five years a small but influential band of futurists have been wringing their hands in public about U.S. population trends. Made up primarily of writers, led by Ben Wattenberg, and economists, Julian Simon and Clark Reynolds among others, this group foresees an imminent — and threatening — decline in the size of the U.S. population. “There is a no-growth future ahead,” Wattenberg warned in a recent column, “leading to a demographic deficit” that portends larger “budget deficits and future Social Security shortfalls,” not to mention a collapse in America’s “geopolitical and cultural influence.”

Such high stakes call forth grand proposals. In the *Birth Dearth*, Wattenberg suggested that the federal government could avert these disasters by paying parents \$2,000 a year for each child under age 16; the price tag would be \$110 billion or so — unless the plan worked, in which case the bill would be higher still. Reynolds has called for a massive, European-style guestworker program, even though every European country with such a program has canceled it after experiencing major problems. Simon’s solution is to increase permanent legal immigration to a million a year, from its current level of about 625,000.

Ideas for major new spending programs do not get far in Washington these days, and the Wattenberg baby bonuses have been no exception. But immigration levels can be

raised without an appropriation, and the fear of population decline is being used as a rationale for the largest increases in the history of U.S. immigration law. One bill passed in the Senate this summer, others are pending in the House. Combined with current law, these could push immigration to more than six million over the next five years alone.

While there are many sound arguments on both sides of the immigration debate, the demo-doom rhetoric is more fear than fact. Though new to American ears, it dates back to the 1870s, when French intellectuals called low birth rates “race suicide” and proclaimed *Finis Galliae*. By the 1930s demographers throughout the Western world had taken up the alarm, gloomily proclaiming that Western societies would soon disappear. Before policymakers buy the latest iteration of this demo-doom scenario, they would do well to consider five myths that frequently cloud clear thinking on population and America’s future.

Myth 1

The United States faces imminent population decline unless we increase immigration or births.

Actually, the population of the United States is not shrinking; it is growing faster than any of the world’s other developed countries. The National Center for Health Statistics reports 3.9 million births and 2.2 million deaths in 1988. Accepting the Census Bureau’s very conservative estimate of 600,000 annual net immigrants (legal and

Roger L. Conner is a guest scholar at Brookings, where he is writing a book entitled U.S. Immigration Policy, 1979–89.



illegal), the population is expanding by 2.3 million people a year.

Although the demo-doomsayers make it seem that decline is around the corner, when pressed they concede that what really concerns them is the size of the population 30 years and more from now. According to Wattenberg, under the "most likely" scenario the population will grow from its current level of 248 million to 300 million about 2020. It will stabilize at that level until 2050 and then return to 260 million or so by 2080. It is to avert the adverse consequences they associate with this scenario that moves the demo-doomsayers to insist that policymakers act now.

Even if government leaders were to assume that population stabilization or gradual decline would be bad, patience is called for. Long-range demographic projections have historically been off by huge margins. In 1944, for

example, the Ben Wattenberg of his day, Dr. Frank Notestein, predicted that the combined population of the United States and Canada would be only 176 million in 1980 and called for government policies to promote larger families to avert a dismal future. Fortunately policymakers did not heed his warnings. Notestein was only off by 70 million or so. It is error of this magnitude, repeated over and over again, that makes trained demographers leery of treating long-range projections as certainties on which current policy should be based.

Harvard's Dr. Nathan Keyfitz, one of the grand old men of American demography, recently compared past population projections with what actually happened. He found that "relatively short term forecasts, say up to ten to twenty years, do tell us something, but beyond a quarter century or so we simply do not know what the population will be."

Keyfitz argues that demographers are no better today than in the past at predicting the key variable in the population equation: how many children women will choose to have. Tiny errors in fertility assumptions are compounded over time, producing massive errors in projections that run beyond a decade or so. "We know virtually nothing about the population fifty years from now," Keyfitz concludes. "We could not risk better than two to one odds on any range narrower than 285 million to 380 million for the year 2030."

Recent experience suggests that it would be quite easy to expand immigration in 30 or 40 years if the demo-doomsayers' fears are realized. The reverse is not so simple. An immigrant stream inevitably creates a potent coalition of employers who want to keep a convenient labor supply coming, recent arrivals who want to bring friends and relatives, church leaders who identify with the aspirations of their new members, and civil libertarians who automatically assume that any restrictive law is motivated by ethnic or racial animus. And if today's level of illegal immigrants is any indication, once immigration flows are under way, more people, tempted by reports from friends of life in the United States, might ignore or evade any immigration restrictions that are imposed in the future.

Managing the possibility of future population decline with expanded immigration is like managing possible future recessions by creating entitlements, tempting in the short run and very difficult to reverse in the long run.

It follows that if the U.S. population does not decline as the demo-doomsayers expect, the consequences they worry about are unlikely to occur either. Let us assume for the sake of argument, however, that their population forecasts are correct and go on to examine whether the anticipated consequences are as adverse as they fear.

Myth 2

Immigration is needed to help "solve the Social Security problem."

In one recent essay, Wattenberg predicted a shortfall in the Social Security fund if population growth stops after 2020. Increased immigration is the best solution, he argued, because the immigrants will be paying taxes "when the baby-boomers start retiring."

This is the wrong "solution" to the wrong "problem." Thanks to recent increases in tax rates, the Social Security trust fund is generating an annual surplus of \$55 billion, which will grow to \$150 billion a year by 1994 and continue for the foreseeable future.

What about 2020 and beyond? A recent Brookings study, *Can America Afford to Grow Old?*, argues persuasively that even if the demo-doom demographic projections turn out to be correct, fears that the retirement of the baby-boom generation will bankrupt the system are overblown. With only modest increases in productivity, the study found, Social Security revenues and benefits will be in balance, without increasing tax rates, well beyond the middle of the next century.

To put it another way, if the workers of the future are more productive and, perforce, more highly paid, they can comfortably generate the revenues needed to support an increasing number of retirees. Future productivity, in turn, will depend on increasing savings, decreasing government deficits, improving labor-management relations, and a host of other factors. There is no evidence that increased immigration will help resolve these central problems. Indeed, immigration has been at historic highs during the past 15 years, a period during which productivity growth has slumped and government deficits expanded.

Henry Aaron, co-author of the Brookings study, puts this all in perspective: "My wife and I do not decide on whether to adopt a child based on the possibility that my income will grow so slowly that I will need support from my children when I grow old. Rather I try to save enough so that I will accumulate enough to live on. That is my advice for funding future Social Security obligations. Then I can decide about whether to adopt a child for the important reason — do I want a larger family?"

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The reverse is not so simple."*

The immigration "solution," in fact, could worsen any long-term problem with financing the system. Adults who immigrate today will retire while the baby boomers are still alive and drawing Social Security. How many more immigrants will be needed to finance their retirement?

In addition, the government's future liability to immigrants who are entitled to receive Social Security benefits after having made minimum payments should give pause to those who see them as a long-term asset to the system. Most immigrants work and pay Social Security taxes but for fewer years than natives. Some arrive in mid-career; up to 30 percent return home before retirement. But virtually all of them will receive benefits. In 1983 the General Accounting Office studied 194,000 non-citizen Social Security recipients. They had, on average, worked 10.5 years of Social Security-covered employment, compared

with 20.5 for all recipients, and had four times as many dependents as the overall beneficiary population.

The demo-doomsayers are correct that immigrants paying into Social Security now will add to the retirement fund's surplus in the short term, but this contribution proves to be less than imagined. Families with taxable incomes below \$19,000 receive an earned income credit. For families with income below \$10,000, the credit exceeds their Social Security taxes; those with incomes between \$10,000 and \$19,000 receive a partial reimbursement. A Census Bureau study found that as of 1980, more than half of all immigrants who had arrived between 1970 and 1979 had incomes low enough to qualify for the tax credit.

Finally, even if there were a clear tax benefit at the federal level, there are offsetting costs at the state and local level that federal policymakers should take into account. Immigrants tend to concentrate in rapidly growing urban areas where the demand for publicly financed schools, health care, and housing exceeds supply. The Urban Institute, for example, found that in California, services for the average family of Mexican origin resulted in a net cost to state and local taxpayers of \$2,245 a year. Even though few of these families received welfare, their incomes were too low to generate enough taxes to cover the cost of these services.

Myth 3

A slowdown in population growth will harm the economy by creating a "customer shortage."

The demo-doomsayers are also concerned that a slowdown in the rate of growth of the population will mean slackening in consumer demand, a "customer shortage." Here, they make the fundamental error of equating numbers with purchasing power. Switzerland, with a population of 6.2 million, and Norway, with 4.9 million people, are better markets than Nigeria, even though its population is 111.9 million.

They also make much of the anticipated rise in the median age of the population, which is now 33. It is true that a more mature population will buy a different mix of products; 40-year-olds will listen to more '60s releases and less hard rock. A more mature work force will also have proportionately fewer 20-year-olds and more experienced 45-year-olds in prime working years, with fewer dependent children as well as more dependent aged.

It is pessimistic in the extreme to fear that American companies cannot adjust to such changes in the marketplace. The median age rose more than twice as fast in the last 20 years as it will in the next 20, even accepting the worst demo-doom scenario. What does it matter to the economy if Johnson & Johnson features adults instead of babies in its commercials for shampoo and powder?

There is a special irony when such fears emanate from scholars associated with the Heritage Foundation (Simon) and the American Enterprise Institute (Wattenberg) and from *Forbes* magazine. These are the same places from which objections to government regulation are routinely

issued on the grounds that the market can adapt, even when it comes to events — like international competition or leveraged buyouts — that hit with greater force and less warning than demographic changes.

Myth 4

Population growth has no significant impact on pollution, natural resources, or the quality of life.

For years ecologists have been preaching that a larger population would put dangerous pressure on natural resources. Demo-doom convert Malcolm S. Forbes, Jr., recently called for legal immigration of 1.5 million a year to avoid a slowdown in population growth. Forbes complained that "we have been overly influenced by nonsensical notions that more people mean more pollution." After all, he said, "man invents technology that can reduce pollution overall."

Forbes and his colleagues seem to have something approaching a mystical faith in the power of technology to bail us out of any environmental problems that arise from the increase in human numbers. A look at Los Angeles might begin to shake that faith. Despite the best pollution controls technology provides, the air in the Los Angeles region violates the clean air act's health standards more than 100 days a year. That is because reductions in the pollutants each car emits have been overwhelmed by the increased numbers of people driving.

The Environmental Protection Agency has concluded that the only way to provide safe air to the people in Los Angeles is to restrict people's right to drive and to invest heavily in mass transit and vehicles powered by alternative fuels. Contemplating such costs, most Los Angelenos probably agree with humorist Andy Rooney. "I haven't noticed that bigger is better anywhere but in basketball," Rooney recently admonished the demo-doomsayers. "Our

*"The demo-doomsayers . . . argue
that unless immigration is
increased, the labor market
will continue to tighten. . . . So
what if it does tighten further?
The market will respond."*

little town has doubled since we moved here 35 years ago, and I still like it, but it isn't twice as good since it got twice as big, I can tell you."

Overcrowding and unrelenting traffic congestion are only the tip of the iceberg. Irreversible ecological changes brought on by the needs of an expanding population are far more serious. The exhaustion of groundwater supplies, destruction of agricultural land, erosion of topsoil, loss of wilderness and natural areas, filled-in wetlands, and diminished wildlife habitat are only part of the list. There are also costs that cannot be measured in dollars, as when regular, intimate contact with untamed nature is an experience reserved increasingly for the well-to-do.

Serious people see these losses as trade-offs to be weighed against other social values that immigration unarguably provides. The demo-doomsayers simply dismiss them as unworthy of concern.

Myth 5

A decline in the population coupled with the aging of the population means a labor shortage that will harm the economy unless immigration is increased.

There is no evidence of a general labor shortage in the United States today. More than six million workers are unemployed. As economist Robert Kuttner points out, this official figure takes no account of more than six million workers who are discouraged from seeking jobs, more than five million who are involuntarily working part-time, and more than one million who hold temporary jobs.

To be sure, there are spot shortages, particularly in areas with exceptionally high housing costs and in certain specialized skill categories, but immigration is a very blunt tool for meeting such needs. The majority of immigrants admitted to fill specific jobs go to work elsewhere within a short time, according to a study funded by the Labor Department. Some apparently exaggerate their qualifications and cannot do the job for which they were selected; some move to other jobs or locations. Talented immigrants obviously contribute to the country and to the economy just as talented natives do. But we should not expect to solve specific labor shortages through immigration unless we are willing to shackle immigrants to the bench or reinstate indentured servitude.

The demo-doomsayers are content to make a broader point. They argue that, skills aside, unless immigration is increased, the labor market as a whole will continue to tighten over the next few years.

So what if it does tighten further? The market will respond. The real question is what the pattern of adjustment will look like. Who will win, and who will lose? Some employers will be forced to offer higher wages and improved working conditions, especially in those sectors where immigrants cluster. Other employers will change their attitude toward workers they now disdain because of age, sex, disability, or race. Managers and entrepreneurs will have an incentive to use this more expensive labor force

more productively. Some of the sweatshops will move to Mexico or Jamaica, taking the jobs to the people instead of bringing the people to the jobs.

It is this dynamic capacity for adjustment that explains why past predictions of labor shortages have not come to pass. It also explains why some employers are so enthusiastic about the demo-doom argument: population growth from increased immigration offers relief from market processes that would otherwise raise wages and working conditions.

To rephrase the earlier question, will a tighter labor market and consequent relative rise in the incomes of workers — especially the lower-skilled who compete with immigrants — be a good or bad policy outcome? Where you stand often depends on where you sit. Jay F. Rochlin, the director of the President's Committee on Employment of People with Disabilities, is cheered by the prospect of a tighter labor market. "Demographics have given us a 20-year window of opportunity" for "millions of Americans with disabilities" he observes. Low-skilled workers would benefit, not only from higher wages but also from the improved schools, churches, and public services they could support. Immigrants who have been here only a short time would benefit most, as they compete most directly with newcomers. A tighter labor market would dismay business owners who have benefited from lower wages or cheaper immigrant labor in the past, though entrepreneurs in sectors or regions without access to this labor supply would see it differently.

Recent shifts in income distribution have consistently favored higher-skilled and professional workers over their fellow citizens who work at lower-skilled service and production jobs. It is well known that real per capita income was relatively flat in the United States between 1973 and 1986; it is less often realized that lower-skilled workers sustained a marked decline in wages. Between 1973 and 1986, for example, 20- to 29-year-old males with high school degrees who did not attend college suffered a 25 percent decline in real income on average; for working male high school dropouts, it was 38 percent. This development provides a strong argument on grounds of equity that the government should not step in with immigration to interrupt market forces that might, for once, operate in favor of society's less advantaged.

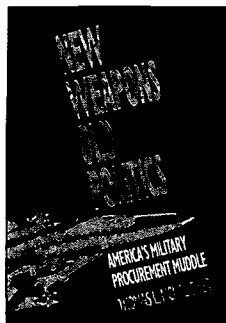
In summary, it would be a mistake to change immigration policy now on the basis of a projection that the U.S. population will stabilize between 2020 and 2050, then decline very slightly over the next 30 years. Even if such projections turn out to be right, there is no reason for alarm.

It is, after all, a biological and physical fact that the population of the earth cannot grow indefinitely. By logical inference, every country in the world must ultimately pass through the transition that so frightens the demo-doomsayers — from growth to stabilization, with fluctuations thereafter. How ironic if the United States, which has spent the post-World War II era preaching the virtues of reduced population growth to the developing world, should react in panic at the prospect of stabilizing its own.

Beyond Waste and Fraud

New Weapons, Old Politics
America's Military
Procurement Muddle

By Thomas L. McNaugher
 \$14.95 paper; \$34.95 cloth



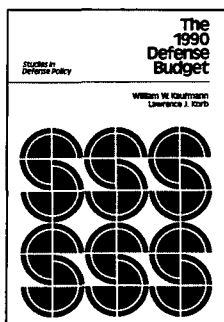
The Pentagon spends more than \$100 billion a year to buy weapons, but no one likes the process that brings these weapons into existence. The problem, writes Thomas L. McNaugher, is that the technical needs of military planners and weapons engineers clash sharply with the political demands of Congress. In *New Weapons, Old Politics*, McNaugher examines weapons procurement since World War II and shows how repeated efforts to improve acquisition have instead increased the harmful intrusion of political pressures into the technical development and procurement process.

Today's weapons are more complicated than their predecessors. So are the nation's military forces. The design of new systems and their integration into the force structure demand more care, time, and flexibility. Yet time and flexibility are precisely what political pressures remove from the acquisition process. McNaugher, a senior fellow in the Brookings Foreign Policy Studies program, calls for changes that run against the current fashion — less centralization of procurement, less haste in getting new weapons on the production line, and greater use of competition in both development and procurement.

Staying Prepared

The 1990 Defense Budget

By William W. Kaufmann
 and Lawrence J. Korb
 \$8.95 paper



After unprecedented peacetime growth in defense appropriations from 1981 through 1985, Congress began to impose real reductions in 1986. Ronald Reagan's last budget called for 2 percent real growth for the next five years. Where should the defense budget go from here?

In *The 1990 Defense Budget*, William W. Kaufmann and Lawrence J. Korb critically examine the defense program that will guide this nation in the coming decade. They review the military buildup and the five-year defense plans of the second Reagan term and the modifications that the Bush administration proposed in its first months

in office. Then, considering likely international situations and U.S. military requirements and commitments, the authors present flexible, pragmatic, and detailed proposals that would allow America's conventional and nuclear forces to maintain preparedness within a budget more limited than any envisioned just a few years ago.

Kaufmann, a consultant to the Foreign Policy Studies program at Brookings, is professor emeritus at MIT and lecturer at Harvard's Kennedy School of Government. Korb is director of the Brookings Center for Public Policy Education and senior fellow in the Foreign Policy Studies program. Both men have written numerous books on defense and the defense budget.

Paying for Health Care



In 1983 Congress changed the way Medicare reimburses hospitals. The goal was to slow the relentless growth in the program's expenditures for hospital care, which had ballooned from \$5 billion in 1970 to \$37 billion in 1982. Under the new prospective payment system, Medicare pays a fixed rate, set in advance and based on the patient's diagnosis, to cover the patient's stay in the hospital. If costs are less than the fixed rate, the hospital keeps the profit; if costs are more, it absorbs the loss.

From the beginning, prospective payment was recognized as a revolutionary change in Medicare. Congress wanted a law that would make federal expenditures more predictable and controllable, and it expected hospitals to respond by becoming more efficient and making greater use of alternative kinds of care. But many recognized that if payment limits were overly strict, hospitals might cut beneficial services to reduce their costs.

Enough time has now passed to assess the performance of the new system on both financial savings and the quality of care. Louise Russell does just that in her new book *Medicare's New Hospital Payment System: Is It Working?* She finds that prospective payment has accomplished its primary goal by achieving substantial savings without shifting costs to other payers. The available evidence does not show any clear-cut deterioration in quality. But reliable data on this question are hard to come by, and Russell recommends that surveillance be continued and improved.

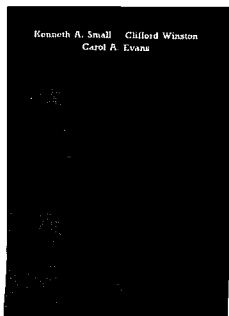
Russell is research professor of economics in the Institute for Health, Health Care Policy, and Aging Research at Rutgers University and professor in the Department of Economics. She is a former senior fellow in the Brookings Economic Studies program.

Medicare's New Hospital Payment System: Is It Working?

By Louise B. Russell

\$8.95 paper; \$22.95 cloth

The Route to Better Roads



No one needs to be told that America's roads are deteriorating and that traffic congestion is getting worse. Yet there is little agreement on what can be done about it. Federal, state and local governments, the driving public, highway contractors, the railroad, trucking, and mass transit industries all have strong and conflicting interests in the road system. Recent policy lacks clear objectives and rationale, and the only consensus to emerge so far is that public spending must be increased. In *Road Work*, Kenneth A. Small, Clifford Winston, and Carol A. Evans propose a comprehensive highway policy based on two

economic principles: efficient pricing to regulate demand, in this case, use of the

Road Work: A New Highway Pricing and Investment Policy

By Kenneth A. Small, Clifford Winston, and Carol A. Evans

\$22.95 cloth

highways; and efficient investment to minimize the total costs of maintaining the roads.

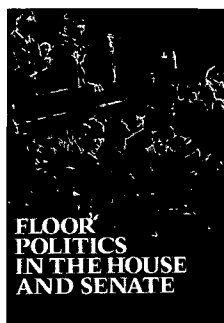
The policy has three main components. Trucks would be assessed pavement-wear taxes based on axle weights, which would raise revenue and discourage use of trucks that do the most damage to roads. All drivers would be charged for their use of the road during peak travel hours, which would not only raise revenue but also ease congestion by encouraging motorists to use different routes or other modes of transportation or to travel at different times of the day. Finally, the authors recommend that roads be built to optimal durability. Although it is more expensive to build thicker roads initially, longer-lasting pavement, especially on heavily traveled roads, would save money in the long run.

The authors believe their proposals should be especially attractive to policymakers because they can be implemented with current technology, offer little threat to major interest groups, and, over the long haul, will reduce the strain on government highway budgets. Small is a professor of economics at the University of California, Irvine; Winston is a senior fellow in the Brookings Economic Studies program; and Evans is a former research assistant in that program.

Floor Politics in Transition

Call to Order: Floor Politics in the House and Senate

By Steven S. Smith
\$11.95 paper; \$31.95 cloth



In *Call to Order*, Steven S. Smith addresses a little-studied aspect of change in Congress since the 1950s: the shift from committee-centered to floor decisionmaking. The number of floor amendments to committee bills began to grow in the 1960s and skyrocketed over the next few years. This development was central to the challenges to the old power structure in the early 1970s and contributed to the sense of uncertainty and instability that was pervasive in the mid-1970s.

Smith investigates how the House and Senate, in their separate ways, responded to the changing character of floor activity. He argues that the House developed new strategies to reduce the hazards that expanding floor activity had created for the majority party and the standing committees, while the Senate continues to struggle with obstructionism and rampant individualism.

The author concludes with an analysis of how developments on the chamber floors have affected committee power. He shows that while Congressional Committees have lost much of their former autonomy, they still are robust forces in policy making.

A former senior fellow in the Brookings Governmental Studies program, Smith is associate professor of political science at the University of Minnesota and co-author of *Managing Uncertainty in the House of Representatives* (1988).

To the Editor

More on Pussycats and Termites

Charlie Schultze in his article "Of Wolves, Termites, and Pussycats," (Summer 1989) has me wrong. I do love pussycats, and I also fear termites gnawing at the foundations of our future prosperity.

Correctly measured, national saving is probably too low. The culprit, though, is not "the deficit," except for the efforts it provokes to reduce it.

Structural deficits have been associated over most of our post-World War II history with growth in real GNP, consumption, and gross private domestic investment, and understandably so. When we produce and consume more, business has the incentive to invest more. And with more domestic investment, there is generally more national saving.

The greatest threat by far to private saving and investment is slow growth and recession. I wonder if these are really 45th on Charlie's list of fears. I am all for easing monetary policy to stimulate domestic investment and, by allowing the dollar to fall, to stimulate net exports and foreign investment (that is, U.S. investment abroad) as well. And this would in fact reduce the actual, measured deficit. Reducing the primary, structural deficit would be in order only when we were sure the economy was "overheated" by excess demand and cramped by labor shortages.

Despite the great reductions in unemployment, not unrelated to the large deficits of the 1980s, excess-demand labor shortages are hardly the case now. I never accepted those 6 and 7 percent "natural" rates of unemployment — now 5 percent? — and don't see why we have to wait on another war to get unemployment to the 3 percent range of 20-odd years ago.

The decline in the ratio of net national saving to GNP turns out to have been more than fully accounted for by two factors: increases in the ratio of capital consumption allowances to gross investment, and the shift to negative net foreign investment. The first, as pointed out in a new paper by Paul Pieper, is in large part the mathematical consequence of declining rates of growth. The slower the rate of growth of investment, even if it remains a constant proportion of income and output, the more depreciation will approach it; at zero growth, net investment is zero. The second, while seriously mismeasured by a failure to account for changes in the market value of our direct investment abroad, is largely chargeable to and correctable by movements of exchange rates.

Increasing national saving requires increasing domestic and/or foreign investment. Reducing the budget deficit is more likely to reduce domestic investment and will directly increase foreign investment (reduce our current account deficit) only to the extent that slowing our economy reduces our imports.

National wealth is the foundation of productivity, now and in the future. But most important, and this is where conventional wisdom and, I fear, Charlie go most astray, that wealth consists of human and nonhuman capital in all sectors of the economy — households, nonprofit institutions, and government as well as business — and our investments abroad net of foreign claims on our assets. The creation of much of it, in education, basic research, public health, and essential infrastructure, is necessarily financed by government spending. Since that spending counts in our official measures of the deficit as "public dissaving," the total saving and wealth with which Charlie

should properly be concerned has only a very partial and frequently perverse relation to conventional measures of "net national saving."

My estimates of the proportion of total capital accounted for by conventional "national saving" measures are between 15 and 20 percent, and some others are considerably lower. But it is the composition — whether for "Star Wars" or investment in nonmilitary productivity — and the total of that other 80 or 85 percent that is directly subject to public policy decisions.

Barring "a relatively substantial tax increase," which Charlie acknowledges "neither the American people nor their political leaders seem willing to accept," the harping on reducing our mismeasured deficit makes it all the more difficult to increase the largely public investment on which our future depends.

Robert Eisner

William R. Kenan Professor of Economics
Northwestern University

Measuring Wealth

Although I have considerable sympathy with the view that Americans should be encouraged to save more, and certainly agree that the danger posed by the federal deficit is long-term decline, not a sudden crisis, I would question Schultze's argument at several points ("Of Wolves, Termites, and Pussycats," Summer 1989). In particular, I was struck by two omissions. First, he makes no reference to the trade-off between consumption today and consumption tomorrow — in other words, to the yield on saving and the rate of return on investing. Second, there is no discussion of the possible reasons we might object to the level of asset accu-

mulation chosen by free individuals in a well-functioning capital market. My purpose in writing, though, is to respond to Schultze's objections to the approach I have suggested to the measurement of national saving.

Schultze seems to imply that I would change the concept of saving from the difference between income and consumption in a given year. His observation hides the fact that what is at issue is the definition of income. A long tradition, most emphatically supported by Brookings economists over the years, holds that a family's income is the sum of what it consumes during the year and what it adds to its stock of wealth. Wealth in this conception is normally understood as the family's net worth, measured at market value (for example, of real estate or common stock). At the family level, then, it is clear that what I mean by saving is the difference between consumption and income, as income has come to be understood by those who would use it as a measure of well-being. The same would be true at the national level, if one defined national income and wealth as the sum of the income and wealth of all American families.

The critical question is how one thinks about national wealth. Schultze would have us focus on the national

income and product account (NIPA) concept. The NIPA capital data can be thought of as the book value of reproducible assets owned by Americans, where the accountants have used the NIPA depreciation conventions and adjusted their historical cost-based entries on assets (including inventories) annually to reflect what they would be had historical prices been instead at current levels. NIPA net saving is the change in this stock. The virtue of the NIPA concept is its apparent reference to real physical stuff. It is easy to think of NIPA capital as the real tools with which American and other (since foreign-owned capital is subtracted and U.S.-owned capital abroad is added) workers work. But ultimately, the depreciation conventions that are critical in getting to NIPA capital must refer to the market's evaluation of assets' productive power. That is, the valuation of assets in capital markets gives the best measure we have of the productive potential of those assets.

The accountants' measure of capital is a piece of information that market participants use in reaching their assessment. But it is the assessment of market participants (or its equivalent, if someone has a better way of judging future productivity) to which we should refer in evaluating our situation.

Referring just to the equity claims on the corporate sector of the United States, the ratio of the market's assessment to the accountant's measure has varied in a range between 37 and 105 percent, and was about 64 percent at the end of 1987. In one way or another, the differences are to be explained by elements of information that the market respects but that the accounts do not record. Examples:

- an oil shock that causes existing equipment and structures to match up badly with the price of inputs.

- discovery of new computing or information transmission technology, or a new oil reserve, that greatly multiplies the future productivity of existing tangible and organizational assets.

To be sure, the market's evaluation of wealth is volatile. To be sure, there are problems galore with index numbers—Schultze describes a couple. But the volatility of wealth is a perhaps regrettable fact of life, and the way to deal with index number problems is to confront them and not to accept less informative accounting data.

David F. Bradford
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